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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1962

No. 96

UNITED STATES, PETITIONER,

vs.

BUFFALO SAVINGS BANK

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

PETITION FOR CERTIORARI FILED APRIL 30, 1962
CERTIORARI GRANTED JUNE 11, 1962

SUPREME COURT OF THE UNITED STATES

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INDEX

	Original	Print
Record from the County Court of Erie County, State of New York		
Notice of appeal to Appellate Division	3	1
Judgment appealed from	6	3
Notice of motion for judgment	15	9
Affidavit of John H. Little	16	9
Memorandum opinion of Hon. Burke H. Burke, dated October 18, 1960	29	12
Per curiam opinion of Appellate Division of July 1, 1960	40	19
Order of Appellate Division of July 1, 1960	45	23
Judgment reversed by Appellate Division, Decision of July 1, 1960	48	24
Decision of County Court of Erie County of June 9, 1959	55	29
Opinion by Judge Burke of County Court of Erie County of May 29, 1959	68	37
Complaint	76	42
Answer of United States of America	87	49
Notice of motion to strike answer and for summary judgment	92	51
Affidavit of Evar J. Skoog	93	52

	Original	Print
Record from the County Court of Erie County, State of New York—Continued		
Counter motion of the United States designated "Answer to Plaintiff's Petition and Motion"	97	55
Notice of appeal to Court of Appeals	105	58
Appellate Division order of modification entered May 18, 1961	108	60
Appellate Division opinion of May 18, 1961	115	64
Modified judgment of Erie County Court June 13, 1961	140	68
Opinion of Court of Appeals of New York, Burke, J.	150	74
Dissenting opinion, Fuld, J.	158	83
Remittitur of Court of Appeals	165	91
Order allowing certiorari	169	93

[fols. 1-3]

IN THE COUNTY COURT—ERIE COUNTY, STATE OF NEW YORK

BUFFALO SAVINGS BANK, Plaintiff,

v.

BEVERLY VICTORY, Individually and as Administratrix of the Estate of JOSEPH B. VICTORY, also known as JOSEPH VICTORY, deceased; MARILYN M. VICTORY; DUANE B. VICTORY; THE WESTERN SAVINGS BANK OF BUFFALO; UNITED STATES OF AMERICA; B. & L. MOTORS INC.; DAVID COLE doing business under the name of DAVE COLE MOTORS, as successor in interest to DAVID COLE and EDWARD COLE, doing business as DAVE COLE MOTORS; THE GRAMATAN NATIONAL BANK AND TRUST COMPANY OF BRONXVILLE; AGNES B. THUMAN, as Executrix of the Last Will and Testament of SYLVESTER C. THUMAN, deceased; MANUFACTURERS AND TRADERS TRUST COMPANY; THE PEOPLE OF THE STATE OF NEW YORK; ALMIN JONES, Defendants.

NOTICE OF APPEAL TO APPELLATE DIVISION—Dated November 18, 1960

Please Take Notice that the United States of America, a defendant in this action, hereby appeals to the Appellate Division of the Supreme Court, for the Fourth Judicial Department from the final judgment of foreclosure and sale of the County Court entered herein in the office of the Clerk of Erie County on the 20th day of October, 1960 whereby it was adjudged that the answer of the said United States of America be stricken out, that the mortgaged premises [fol. 4] herein be sold free and clear of all local real estate taxes, assessments and water rates which will or may become liens on the premises at the time of the sale, but that such local real estate taxes, assessments and water rates be paid out of the process of the sale as an expense of the sale, and the liens of the United States of America having an earlier priority be paid thereafter, if sufficient funds remain therefor.

And Please Take Further Notice that the appellant intends to bring up for review on such appeal a memorandum

of the Court entered in the said Clerk's office on the 18th day of October, 1960, directing that the Clerk enter judgment for the relief demanded in the complaint and that said judgment provide for sale by the referee and payment of such local taxes and assessments as a cost of the sale and in priority of the liens of the United States.

Dated: Buffalo, New York, November 18, 1960.

Neil R. Farmelo, United States Attorney in and for the Western District of New York, Attorney for Defendant, United States of America, Office and Post Office Address, 502 United States Courthouse, Buffalo 2, New York. By: /s/ C. Donald O'Connor, Assistant United States Attorney.

[fol. 5] To: Little & Burt, John F. Little, Esq., of Counsel, Attorneys for Plaintiff, Buffalo Savings Bank Building, Buffalo 3, New York. Evan E. Janes, Esq., Guardian ad Litem for Defendant Marilyn M. Victory and designated attorney for Defendant Duane B. Victory, Prudential Building, Buffalo 2, New York. Moot, Sprague, Marcy & Gulick, William H. Gage and Thomas G. Ricket, Esqs., of Counsel, Attorneys for Erie County Savings Bank, Amicus Curiae, Erie County Savings Bank Building, Buffalo 2, New York.

[fol. 6] In the County Court—Erie County

Buffalo Savings Bank, Plaintiff,

v.

Beverly Victory, Individually and as Administratrix of the Estate of Joseph B. Victory, also known as Joseph Victory, deceased; Marilyn M. Victory; Duane B. Victory; The Western Savings Bank of Buffalo; United States of America; B. & L. Motors Inc.; David Cole doing business under the name of Dave Cole Motors, as successor in interest to David Cole and Edward Cole, doing business as Dave Cole Motors; The Gramatan National Bank and Trust Company of Bronxville; Agnes B. Thuman, as Executrix of the Last Will and Testament of Sylvester C. Thuman, deceased; Manufacturers and Traders Trust Company; The People of the State of New York; Alvin Jones, Defendants.

Judgment Appealed from—October 20, 1960

The above named defendant, United States of America, [fol. 7] having appealed to the Appellate Division of the Supreme Court in and for the Fourth Judicial Department, from the judgment of the County Court, Erie County, entered in the office of the Clerk of the County of Erie on June 9, 1959; and the said appeal having been duly heard, and the said Appellate Division having thereupon by its Order dated June 29, 1960, duly unanimously ordered and adjudged that the said judgment, insofar as appealed from, be reversed on the law and in the exercise of discretion and the case be remitted to this Court for further proceedings in accordance with the opinion of said Appellate Division, without costs to any party; and the said order of reversal having been duly filed in the Office of the Clerk of said Appellate Division on July 1, 1960; and a copy of said Order, together with notice of entry thereon having been duly served on the same day on Messrs. Little and Burt, the attorneys for the said plaintiff, and Neil R. Farmelo, Esq., the attorney for the defendant, United States of America, and the remittitur and record on appeal, together with certified copies of said order of reversal having duly been

remitted to the Office of the Clerk of the County of Erie, and duly filed on the 8th day of July, 1960; and plaintiff having moved for further proceedings in this Court pursuant to said order of June 29, 1960, and after having heard arguments of counsel,

Now, on motion of Little and Burt, attorneys for the said plaintiff, it is hereby

Ordered, that the said order of reversal of the Appellate [fol. 8] Division, dated June 29, 1960, be and the same hereby is made the order of this Court, and due proceedings having been had in this Court pursuant to the direction of the Appellate Division by said order of June 29, 1960, it is further

Ordered and Adjudged that the said judgment of this Court herein, dated June 9, 1959, and entered in the Office of the Clerk of the County of Erie on June 9, 1959, be and the same hereby is reversed and a new judgment based on the Decision of Honorable Burke I. Burke, Erie County Judge, dated October 18, 1960, is hereby rendered as follows:

Ordered, Adjudged and Decreed, that the answer interposed herein by the defendant, United States of America, be and the same hereby is stricken out, without prejudice to the defendant, United States of America, participating as a junior lienor in any surplus moneys remaining, as hereinafter set forth, after the payment of fees, costs, expenses of sale and plaintiff's claim for principal and interest; and it is further

Ordered, Adjudged and Decreed, that the plaintiff is entitled to have herein the sum of One Thousand Five Hundred Sixty and 13/100 Dollars ($1,560.13), the sum so due as aforesaid, with interest thereon from the 12th day of March, 1959, besides the sum of Three Hundred Twenty-seven and 90/100 Dollars ($327.90) as taxed by [fol. 9] the Clerk of the Court and hereby adjudged to the plaintiff for costs and disbursements in this action, with interest thereon from the date hereof; and it is further

Ordered, Adjudged and Decreed, that Evan E. James, Esq., is awarded the sum of One Hundred Dollars ($100.00) in full of his services as Guardian *ad litem* and Designated Attorney herein; and it is further

Ordered, Adjudged and Decreed, that the mortgaged premises described in the complaint in this action as here-

inafter set forth, be sold pursuant to Section 1087 of the Civil Practice Act at public auction at the westerly vestibule of the Erie County Hall, Buffalo, New York, by or under the direction of Robert W. McNulty of the Town of Orchard Park in the County of Erie, New York, who is hereby appointed referee for that purpose; that said referee give public notice of the time and place of such sale, according to law and the course and practice of this Court; that the plaintiff, or any other party to this action, may become the purchaser or purchasers on such sale; that said referee execute to the purchaser or purchasers on such sale a deed of premises sold. That the said referee shall, as a part of the expenses of the sale, pay out of the proceeds of said sale all real estate taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid real estate taxes, assessments or water rates which have not apparently become absolute.

[fol. 10] That said referee forthwith, upon receipt of the proceeds of sale or any part thereof, deposit the same in his own name as referee, in the Liberty Bank of Buffalo and that said referee, after the delivery of said deed, pay from the moneys so deposited the referee's legal fees, the allowance to the Special Guardian, the allowance to the Designated Attorney, and the lawful advertising expenses, and pay all real estate taxes and assessments and water rates which were liens upon the property sold, and pay the cost of redeeming said property from any real estate taxes, assessments and water rates which had not apparently become absolute; unless he shall have allowed them to the purchaser as hereinbefore provided, and then to pay to the plaintiff or its attorney the aforesaid costs, disbursements and allowances, with interest, and also pay the said amount hereinbefore adjudged due the plaintiff, with interest, or so much thereof as said moneys will pay, and deposit the surplus, if any then remaining, as hereinafter provided, taking receipts for all such payments and filing the same with his report of sale.

That said referee shall make a report of such sale, and file it with the Clerk of Erie County; and if the proceeds of such sale be insufficient to pay the amount so reported due to the plaintiff, with interest and costs, disbursements

and allowances with interest as aforesaid, that said referee specify the amount of such deficiency in his report of sale, and that the defendant, Beverly Victory, as Administratrix [fol. 11] of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, pay the same to the plaintiff, and upon application, as required by law, that the plaintiff have judgment and execution therefor, or so much thereof as the Court may determine to be just and equitable of the debt remaining unsatisfied; but if there be a surplus, then that said referee shall deposit the same, within five days after its ascertainment, with the Liberty Bank of Buffalo, to the credit of this action, but subject to the further order of the Court herein.' Further ordered that the purchaser or purchasers at such sale be let into possession on production of the referee's deed or deeds.

That in case the plaintiff becomes the purchaser of the said mortgaged premises at said sale, or in the event that the rights of the purchaser at said sale and the terms of sale under this Judgment shall be assigned to or shall be acquired by the plaintiff and a valid assignment thereof be delivered to said referee, said referee shall not require the plaintiff to pay in cash the entire amount bid at said sale, but shall execute and deliver to the plaintiff a deed of the premises sold upon the payment to said referee of the amounts hereinbefore specified as taxed by the Clerk of this Court and adjudged to the plaintiff for costs and disbursements, with interest thereon from the date hereof, the amounts of the aforesaid real estate taxes, assessments and water rates and interest and penalties thereon, and the amounts necessary to redeem the property sold from any sales for unpaid real estate taxes, assessments or water [fol. 12] rates, or, in lieu of the payments of said last mentioned amounts, upon delivering to said referee receipts of proper municipal authorities showing the payment thereof, together with the referee's fees, advertising expenses, and the allowance to the Special Guardian and Designated Attorney, all of which shall be allowed to the plaintiff and applied by the said referee accordingly. If after such application and allowing the plaintiff from the amount for which the property shall have sold as aforesaid, there shall remain of the amount so bid, a surplus over and above the amount due the plaintiff, the plaintiff shall pay to said

referee upon delivery to it or its assigns of said referee's deed the amount of such surplus, and said referee shall thereupon forthwith pay with and out of the same, said real estate taxes, assessments and water rates and interest or penalties thereon unless the same have already been paid, and shall then deposit the balance in said depository as hereinbefore directed.

That said referee take the receipt of the plaintiff, or its attorneys, for the amounts paid as hereinbefore directed and file same with his report of sale; that he deposit the surplus moneys, if any, with the Liberty Bank of Buffalo, within five days after the same shall have been received by him to the credit of this action to be withdrawn only on the order of this Court.

That if the proceeds of the sale be insufficient to pay the amounts so reported due to the plaintiff as aforesaid with [fol. 13] the expenses of sale, interest, costs, allowance, and the real estate taxes, assessments and water rates and interest as aforesaid, that said referee specify the amount of such deficiency in his report of sale and that the defendant, Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, pay the same to the plaintiff, and that the said plaintiff have Judgment and execution therefor upon application as hereinbefore provided; and it is further,

Ordered, Adjudged and Decreed, that each and all of the defendants in this action and all persons claiming under them or any or either of them, after the filing of the notice of pendency of this action, be, and they hereby are, forever barred and foreclosed of all right, claim, lien, title, interest and equity of redemption in the said mortgaged premises and each and every part thereof, except as to the one year period of redemption granted the defendant, United States of America, by Section 2410 of Title 28 of the United States Code Annotated.

The following is a description of the said mortgaged premises hereinbefore mentioned:

All that Tract or Parcel of Land situate in the City of Buffalo, County of Erie and State of New York, bounded and described as follows:

Commencing at a point in the northerly line of Lyth Place, three hundred forty-three and two-tenths (343.2)

feet westerly from its intersection with the westerly [fol. 14] line of Jefferson Street; running thence westerly along said line of Lyth Place twenty-four and four-tenths (24.4) feet; thence northerly at right angles one hundred twenty (120) feet to a point midway between the northerly line of Lyth Place and the south line of Northland Avenue, formerly Puffer Street; thence easterly along the line midway between said lines of Lyth Place and Northland Avenue, formerly Puffer Street, twenty-four and four-tenths (24.4) feet; thence southerly at right angles one hundred twenty (120) feet to the northerly line of Lyth Place at the place of beginning.

Subject to restrictions and rights of utilities of record affecting said premises.

Together With all the right, title and interest of the mortgagor of, in and to the land lying in the bed of any street, road, avenue, lane or right of way as they now exist or formerly existed in, in front of or adjoining the said premises, and in and to all easements, riparian rights and appurtenances and all the estate and rights of the mortgagor in and to said premises.

Together With all fixtures and articles of personal property, now or hereafter attached to, and used in connection with, the above described premises, all of which are covered by said mortgage.

s/ Burke I. Burke, Erie County Judge.

[fol. 15] Granted: October 20, 1960.

s/ O. E. Mueller, Special Deputy Clerk.

IN THE COUNTY COURT OF ERIE COUNTY

NOTICE OF MOTION FOR JUDGMENT—Dated July 28, 1960

Sirs:

Please Take Notice that on the annexed Order of the Appellate Division, Fourth Department, dated June 29, 1960, remitting this matter to the Erie County Court for further proceedings in accordance with the Opinion of said Appellate Division, Fourth Department, the annexed affidavit of John H. Little, verified the 28th day of July, 1960, and the annexed proposed judgment, and application will be made in Erie County Court, Part I, in the Erie County Hall, City of Buffalo, Erie County, New York, on the 4th day of August, 1960, at 9:30 A. M. of that day, or as soon thereafter as counsel can be heard, for the necessary proceedings to enable said County Court to enter a judgment in this matter in accordance with the direction of the Appellate Division, Fourth Department.

Dated: Buffalo, New York, July 28th, 1960.

Yours, etc., Little and Burt, Attorneys for Plaintiff, Office and P. O. Address, Buffalo Savings Bank Bldg., 545 Main Street, Buffalo 3, New York.

[fol. 16] To: Neil R. Farmelo, Esq., Attorney for Defendant, United States of America. Evan E. James, Esq., Guardian ad Litem for Defendant, Marilyn M. Victory. Designated Attorney for Defendant, Duane B. Victory. Messrs. Moot, Sprague, Marcy & Gulick, Attorneys for Erie County Savings Bank, Amicus Curiae.

AFFIDAVIT OF JOHN H. LITTLE IN SUPPORT OF MOTION

STATE OF NEW YORK,

County of Erie, City of Buffalo, ss.:

JOHN H. LITTLE, being duly sworn, deposes and says that he is a member of the firm of Little and Burt, attorneys for the plaintiff, Buffalo Savings Bank, and has had charge of this action since its inception.

That the defendant, United States of America, appealed

to the Appellate Division, Fourth Department, from the final judgment of foreclosure and sale in this action entered in the Office of the Clerk of Erie County June 9, 1959, inso-
[fol. 17] far as it was adjudged that the Answer of the United States of America be stricken out, that the mortgaged premises be sold subject to all local real estate taxes, assessments and water rates, and that the lien of the United States of America be foreclosed.

Thereafter said appeal was argued in the Appellate Division, Fourth Department, and by an order dated June 29, 1960, the Appellate Division, Fourth Department, ordered that the judgment of foreclosure entered herein June 9, 1959, be unanimously reversed on the law and in the exercise of discretion, and that the case be remitted to the Erie County Court for further proceedings in accordance with the opinion of the Court.

That plaintiff now moves this Court for such further proceedings, in accordance with the order of the Appellate Division, Fourth Department, dated June 29, 1960 and for the entry of a new judgment.

That the answer of the United States of America raises no issue of fact and should be dismissed as it was in the original judgment of June 9, 1959, without prejudice to the United States of America to participate as a junior lienor in any surplus moneys remaining after the payment of fees, costs, and expenses of sale (including real estate taxes, assessments and water rates) and plaintiff's claim for principal and interest. The tax lien of the defendant, United States of America, is subordinate to the lien of plaintiff's mortgage and should be foreclosed, with pro-
[fol. 18] vision that the one year period of redemption granted the United States of America by Section 2410 of Title 28 of the United States Code Annotated be preserved by proper recital in the resettled judgment.

That only affirmative relief sought in this action is to obtain the foreclosure of plaintiff's real estate mortgage. Plaintiff concedes that all real estate taxes, assessments and water rates assessed by the municipal authorities within whose bounds the mortgage property lies, are superior to the lien of plaintiff's mortgage no matter if they were levied and assessed before or after the recording of plaintiff's mortgage. Nothing will be gained by bringing in as

parties defendant the City of Buffalo, County of Erie and Buffalo Sewer Authority in an effort to cut off the lien of their taxes and direct that the mortgaged premises be sold free of said taxes, assessments and water rates, since plaintiff cannot succeed in this. Any adjudication as to the relative priority of United States of America's Federal tax lien and said real estate taxes, assessments and water rates is immaterial to the only issue in this law suit, namely, the foreclosure of plaintiff's first real estate mortgage.

The Appellate Division, Fourth Department, in its opinion of July 1, 1960, specifically rejected the request of the defendant, United States of America, that the judgment provided that the problem of the circular priorities be solved by providing in the judgment that, out of the net proceeds of sale, *i. e.*, the funds remaining after payment [fol. 19] of the expenses of sale (not including local taxes) and the plaintiff's costs, there be set aside a sum equivalent to the total of the amount owing on the plaintiff's mortgage and the amount of any other liens superior to the Federal tax lien; that thereafter the Federal tax lien be paid and then the local taxes be paid and that, if there is not enough left to pay the local taxes in full, the balance owing on the local taxes be paid out of the sum orginally set aside and that only the balance then remaining of that sum be paid over to the plaintiff and the other lienors for whose benefit the sum had been set aside.

That since Section 1087 of the New York Civil Practice Act provides for only two methods of conducting a mortgage foreclosure sale, namely, that the referee shall pay the real estate taxes, assessments and water rates as a part of the expenses of sale, unless the Court directs the property to be sold subject to real estate taxes, assessments and water rates, and since the Appellate Division, Fourth Department, has ruled that this Court erred as a matter of law and in its exercise of discretion in directing that the property be sold subject to real estate taxes, assessments and water rates, plaintiff respectfully requests that the resettled judgment shall direct that the said referee shall, as a part of the expenses of the sale, pay out of the proceeds of said sale all real estate taxes, assessments and water rates which are liens upon the property

sold and redeem the property sold from any sales for unpaid real estate taxes, and assessments and water rates [fols. 20-28] which have not apparently become absolute, or he may allow the same to the purchaser as a part of the expenses of the sale, at the time of delivering said deed, upon the production and delivery by said purchaser to the said referee of proper vouchers showing the payment thereof.

John H. Little.

(Sworn to on July 28, 1960.)

In the County Court of Erie County

[fol 29] Little & Burt, John F. Little, Esq., of counsel, Attorneys for Plaintiff.

John O. Henderson, Esq., United States Attorney, William I. Shapiro, Esq., Special Assistant to the United States Attorney, and Donald O'Connor, Esq., Assistant United States Attorney, of counsel, Attorney for Defendant, United States of America.

Evan E. James, Esq., Guardian *ad litem* for Defendant, Marilyn M. Victory, and designated attorney for Defendant, Duane S. Victory.

Moot, Sprague, Marcy & Gulick, Thomas G. Rickert, Esq., of counsel, Attorneys for Erie County Savings Bank, *Amicus Curiae*.

Memorandum Opinion of Hon. Burke I. Burke, Dated October 18, 1960

The plaintiff, Buffalo Savings Bank, and the defendant, United States of America, have appeared before this court on the return day of a motion made by plaintiff for a resettled judgment of foreclosure and sale. A review of the prior proceedings in this matter may serve to clarify the issues presented.

The action was started by plaintiff in October, 1958, to foreclose a first mortgage. The defendants in the action, in addition to the mortgagors, included the holder of a second mortgage, various judgment creditors, and the United

States of America, which was made a party by virtue of a federal tax lien filed subsequent to the recording of the [fol. 30] first mortgage but prior to the accrual of certain local real estate taxes, unpaid at the time of the commencement of the action, and remaining unpaid to the present time.

The complaint requested a judgment establishing the amount due for principal and interest on the first mortgage, together with any moneys advanced by the mortgagee to pay local taxes, and that the mortaged premises be sold to satisfy these amounts and the cost and expenses of the foreclosure action, and that all defendants made parties to the action be foreclosed from any interest in the property. The United States of America served an answer requesting that the judgment of foreclosure require the referee to pay from the proceeds of sale the tax lien of the United States of America prior to the payment of any other unpaid taxes and other charges.

Thereafter, the plaintiff moved for summary judgment and this court granted the motion for summary judgment on the basis that no question of fact had been raised by the pleadings since the lien dates and amounts had been admitted and the only dispute was a question of law as to the priorities to be determined upon the agreed facts. At that time, the court also directed entry of a judgment providing that the mortgaged premises be sold by the referee subject to unpaid local municipal real estate taxes but free of the liens of all other defendants in the action, including United States of America.

The defendants, United States of America, appealed. [fol. 31] from this order and the Appellate Division reversed the judgment of foreclosure insofar as the same had been appealed from by the United States and remitted the case to this court for further proceedings in accordance with the opinion of the Appellate Division.

The opinion notes that a sale of the mortgaged premises, subject to local taxes, while within the power of the trial court, was not appropriate under the particular circumstances and suggested that the premises be sold free and clear of all liens, and that the municipal lienors be made parties to the action. The municipal lienors have not been made parties to the action for the following reason: upon

argument of the present motion, attorneys for the plaintiff and the defendant, United States of America, discussed the matter and it was indicated that if the municipal lienors were made parties, they would be in a position like that of a first mortgagee, made a party to a second mortgage foreclosure action; that is, such lienors would be entitled to have the action dismissed as to them or, in the alternative, to judgment of the court directing that the premises foreclosed, be sold subject to their liens, and that no useful purpose would be served.

There remains again the question of the form of judgment directing the sale, the answer being stricken under the authority of Aquilino v. United States, 3 New York 2d 511. The plaintiff has requested a judgment of foreclosure and sale pursuant to Section 1087 of the New York Civil Practice Act, one directing that the referee sell the [fol. 32] premises and pay out of the proceeds taxes, assessments and water rates which are liens upon the property sold. Under this form of judgment, any such taxes paid by the referee would, pursuant to Section 1087 of the Civil Practice Act, be deemed expenses of the sale, which have priority over all other claims.

The defendant, United States of America, has requested a form of judgment directing that the proceeds of sale be apportioned to the payment of expenses of the sale (except local taxes) and the allocation of the remaining proceeds to the payment of the plaintiff's mortgage and all other liens in order of time, but that if the local taxes are not fully paid after such allocation, that the balance of the local taxes be paid out of the proceeds allocated to the various lienors (excepting the United States of America) in inverse order of their priority in time.

The plaintiff relies upon *Rikoon* v. *Two Boro Dress Co.*, 9 M 2d 591, 171 NYS 2d 19 Mod., 8 A. D. 2d 986, 190 NYS 2d 799 (2d Dep't.) reargued 9 *A.* D. 2d 783, 193 NYS 2d 302, leave to appeal denied, 7 NY 2d 711, while the defendant, United States of America, relies upon *United States* v. *New Britain*, 347 U. S. 81 (1954) as applied in *Dunkirk Trust Co.* v. *Dunkirk Laundry Co.*, 17 M 2d 298, 182 NYS 2d, 381 and *Stadelman* v. *Hornell Woodworking Corp.*, 172 F Supp. 156 (D. C. N. Y. 1958) and also *Prudential Sav-*
[fol. 33] *ings Bank* v. *Prieur et al.*, not reported (Supreme

Court, Erie County 1959). The plaintiff's contention is also supported by *Kronenberg v. Ellenville Nurseries and Greenhouses*, 196 NYS 2d 106, Supreme Court, Ulster County, 1960.

As the Appellate Division noted, it is only in the event that the net proceeds from the sale of the premises are in excess of the amount owing on the plaintiff's mortgage and other liens superior to the federal tax lien, but less than the amount needed to pay all liens in full, that the question of priority of the federal tax lien over local taxes (if any) will arise. In its previous decision, (similar to that of the Supreme Court of Nassau County in Feinstein v. Earl, N. Y. Law Journal, July 5, 1960) this court directed that the premises be sold subject to local real estate taxes.

Since, however, a sale, subject to local taxes, now may not be directed, the question remains whether the court should direct the entry of a judgment of foreclosure and sale in the usual form under Section 1087 of the New York Civil Practice Act, or whether it should grant the special form of judgment requested by the United States of America.

The authority principally relied upon by the defendant, United States of America, is the case of *United States v. New Britain*, 347 U. S. 81 (1954). That case involved the foreclosure by judgment sale of two mort- [fol. 34] gages on real property located in the State of Connecticut. The premises subject to the mortgages brought a gross sum of some $28,000.00 on the sale and pursuant to Connecticut practice, the gross proceeds of the sale were paid into Court, and an application made for a supplementary judgment directing the disposition of these proceeds. There were claims totaling $31,000.00 for expenses of the sale, the two mortgages, a judgment of record and statutory tax liens asserted by the municipality and by the United States. The court below had directed that from the proceeds of sale, the expenses, the local municipal tax liens, the mortgages, the judgment liens and the United States liens be paid in that order, reasoning that the mortgagee could have paid the delinquent local taxes and added the amount thereof to the debt covered by the mortgage liens, which would then have priority over the federal lien, and stating that it did not believe Congress intended, by giving mortgagees and certain judg-

ment creditors priority over federal tax liens, to supersede state laws making certain municipal taxes superior in turn to such mortgages and judgments, and that accordingly this Congressional intent was to subordinate federal liens to such other encumbrances as have priority over the mortgages and judgment liens to which the federal liens are expressly subordinated by federal statute.

In reversing, the United States Supreme Court stated that it did not agree, holding that the United States was [fol. 35] not interested in whether the state received its taxes and water rents prior to mortgagees and judgment creditors since that was a matter of state law, but that as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien and that there was nothing in the language of the federal statute to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interest set out therein.

The various Connecticut sfatutes cited by the United States Supreme Court in the New Britain case involved either the priority of local municipal taxes or the privilege given to the mortgagee to pay such preferred items and add them to the principal due on the mortgage.

However, an examination of the general statutory pattern of mortgage foreclosure procedure in the State of Connecticut reveals that both at the time of the decision of the New Britain case and at present, when a mortgage is foreclosed in Connecticut, the proceeds of the sale of the premises are brought into the court directing the sale, and that thereafter a supplemental judgment is rendered specifying the parties who are entitled to the proceeds of the sale and the amount to which each is entitled. These parties include the plaintiff, although if the plaintiff purchases the premises at the foreclosure sale, he need only bring into court the excess of the sale proceeds over the amount due [fol. 36] on his judgment debt, interest and costs. It is also provided that the plaintiff in a foreclosure action be paid his judgment for principal and interest and his costs, but these costs are not defined and the statute indicates they are to be the costs usually allowed to successful parties. See 49 Conn. Gen. Stat. c. 846 §§ 49-27, 49-29 (1958 Rev.).

By comparison, the New York practice involving foreclosure of mortgages provides in Section 1082 of the Civil Practice Act, that in an action to foreclose a mortgage upon real property, if the plaintiff becomes entitled to final judgment the court must direct the sale of the mortgaged premises, or such portion thereof as is sufficient to discharge the mortgage debt, the expenses of the sale, and the costs of the action, and all surplus moneys arising from the sale of the mortgaged premises shall be deposited by the referee within five days after the sale shall have been held, subject to the further order of the court. Any person claiming the surplus moneys arising upon the sale of the mortgaged premises must initiate a separate surplus moneys proceeding.

Section 1087 of the Civil Practice Act expressly provides that where a judgment rendered in an action to foreclose a mortgage upon real property directs the sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold and redeem the property sold from any [fol. 37] sales for unpaid taxes, assessments or water rates which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale.

It appears there is a distinction between the procedure mandated by the Connecticut statutes and that mandated by the New York statutes. The Connecticut statutes cover disposition of the proceeds of sale, which are analogous to but not identical with the surplus moneys resulting upon a sale in New York.

The form of judgment requested by the defendant, United States of America, goes beyond what is provided for by New York procedure and would, in effect, initiate a surplus moneys proceeding on behalf of the United States of America prior to the sale, which might or might not produce surplus moneys. The United States seeks this special form based upon the assertion that the normal form of judgment would vitiate its claimed priority and that this would be illegal under the federal law which the United States claims is controlling in this instance. It is the court's opinion that this is a matter of state procedure, and

that under the recent decisions in *U.S.* v. *Brosnan*, 80 S. Ct. 1108 (1960) the United States Supreme Court stated it was desirable to adopt as federal law, state law governing divestiture of federal tax liens except to the extent that Congress may have entered the field, and accordingly re- [fol. 38] fused to fashion a federal rule of uniformity respecting the extinguishment of federal junior liens under state procedures. In holding, in these particular cases, that federal liens could be effectively extinguished by non-judicial foreclosures of mortgages and deeds of trust, it would seem that the court indicated there could be a permissible variation of effect upon federal tax liens depending upon the methods of state procedure utilized by the security holder. These statements are consonant with the form of judgment granted in the *Rikoon* and *Kronenberg* cases cited *supra*.

Apart from the legal factors, policy considerations include the following:

The form of judgment requested by the defendant United States of America, would jeopardize the standing of two mortgages and judgments recorded prior to the filing of the United States tax lien merely by reason of the accrual of subsequent real estate taxes. Such a circumstance, subsequent to the docketing of a federal tax lien, should not affect the standing of prior recorded liens, nor furnish the federal government with an advantage over other creditors.

The effect of such a determination would be to spur mortgagees to foreclose immediately upon a tax default, or require substantial escrow deposits by mortgagors to secure payment of subsequent real estate taxes.

[fol. 39] And, if the government's contention were sustained, it could lead to the paradoxical result, in other cases factually similar, wherein U. S. government agencies are cast as bond and mortgage guarantors, that a mortgagee, in effect, would be compelled to pay a mortgagor's income tax to one department of the federal government, Internal Revenue, and then be reimbursed by a different department of the federal government such as the Veterans Administration or the Federal Housing Administration.

As it appears that there is a meaningful difference between the Connecticut procedures involved in the New Britain case and the statutory procedural scheme of New

York set forth in the Civil Practice Act, that the form of judgment requested by the United States of America is at variance with mortgage foreclosure procedure under New York law, and that upon the authority of the Rikoon and Kronenberg cases, the relief asked by plaintiff should be granted, it is the decision of the court that the plaintiff have a judgment of foreclosure and sale, pursuant to Section 1087 of the Civil Practice Act, directing the referee to pay real estate taxes and assessments from the proceeds of sale as expenses, and providing that the United States of America may redeem within one year of the date of sale.

Submit judgment accordingly.

Dated: October 18, 1960. Buffalo, New York.

Burke I. Burke.

[fol. 40] In the Supreme Court of New York
Appellate Division—Fourth Department

Buffalo Savings Bank, Respondent,

vs.

Beverly Victory, and others, Defendants,

United States of America, Appellant.

No. 198

Argued: May 5, 1960

Per Curiam Opinion—July 1, 1960

Present: Hon. Alger A. Williams, *Presiding Justice*. Hon. Earle C. Bastow, Hon. Harry D. Goldman, Hon. Philip Halpern, Hon. William E. McClusky, *Associate Justices*.

Appeal from Judgment of Erie County Court, Burke, J., striking out the answer of the United States of America, granting summary judgment, and directing sale of the mortgaged premises.

Judgment entered June 9, 1959.

[fol. 41] APPEARANCES:

Little & Burt, Attorneys for Respondent, John H. Little of counsel.

Neil R. Farmelo, Acting United States Attorney, Attorney for Appellant, William Schapiro, of counsel.

Moot, Sprague, Marcy & Gulick, Attorneys for Erie County Savings Bank, *Amicus Curiae*, Thomas G. Rickert, of counsel.

PER CURIAM:

The direction in the judgment of foreclosure that the mortgaged premises be sold "subject to all local real estate taxes, assessments and water rates, which are or may become liens on the premises at the time of the sale" is not a proper direction under the circumstances of this case. Under section 1087 of the Civil Practice Act, local real estate taxes, assessments and water rates which are liens upon the property must be paid out of the proceeds of the sale by the officer making the sale "unless the judgment otherwise directs". This authorizes the court to direct a sale of mortgaged premises subject to local taxes in an appropriate case but this authority may not properly be exercised in a case such as this in which there is a problem of circular priorities. While the lien of the local taxes is admittedly superior to the lien of the plaintiff's [fol. 42] mortgage, the appellant United States contends that the lien of the local taxes is inferior to the Federal tax lien by reason of the fact that the Federal tax lien was filed prior to the accrual of the local taxes, but it concedes that the Federal tax lien is, in turn inferior to the mortgage lien, having been filed after the mortgage was recorded. To direct that the property be sold subject to the lien of local taxes in this situation is, in effect, to give the lien of the local taxes a super-priority, in disregard of the fact that the lien of the local taxes is claimed to be inferior to the Federal tax lien. The amount realized upon the sale would undoubtedly reflect the fact that the property had been sold subject to the lien of the local taxes and the proceeds of the sale available for the payment of all other liens, including the Federal tax lien, would be accordingly reduced.

We therefore reverse the direction to sell the property subject to local taxes and we also reverse the provision of the judgment striking out the answer of the appellant and we remit the case to the County Court for the entry of a new appropriate judgment which recognizes the respective priorities claimed.

The appellant requests that the problem of the circular priorities be solved by providing in the judgment that, out of the net proceeds of sale, *i.e.*, the funds remaining after payment of the expenses of sale (not including local taxes) and the plaintiff's costs, there be set aside a sum [fol. 43] equivalent to the total of the amount owing on the plaintiff's mortgage and the amount of any other liens superior to the Federal tax lien; that thereafter the Federal tax lien be paid and then the local taxes be paid and that, if there is not enough left to pay the local taxes in full, the balance owing on the local taxes be paid out of the sum originally set aside and that only the balance then remaining of that sum be paid over to the plaintiff and the other lienors for whose benefit the sum had been set aside. This request is made upon the authority of United States vs. New Britain, 347 U. S. 81 (see also Metropolitan Life Ins. Co. vs. United States, 9 A. D. 2d 356; but see Rikon vs. Two Boro Dress, Inc., 9 A. D. 2d 783, lv. to appeal denied 7 N. Y. 2d 711).

However, there is no way of determining in advance of the sale whether the question of priorities sought to be raised by the appellant will ever arise. If the net proceeds of sale are not sufficient to pay the amount owing on the plaintiff's mortgage and on any other liens superior to the Federal tax lien, there will concededly be nothing left to apply on the Federal tax lien and therefore no question will arise as to the effect to be given to the superiority of the Federal lien over the lien of local taxes. Similarly, if the net proceeds of sale are sufficient to pay all liens, including both the Federal tax lien and local taxes in full, no question of priorities will arise. It is only in the event that net proceeds are in excess of the amount owing on the plaintiff's mortgage and on any other liens superior to [fol. 44] the Federal tax lien, but less than the amount needed to pay all liens in full, that the question of the effect to be given to the priority of the Federal tax lien over local taxes will arise.

In this situation, it may well be that the best way to dispose of the matter is to have the premises sold free and clear of all liens, without determining the manner of distribution of the proceeds prior to the sale, leaving the question of priorities to be decided later, if it should become necessary to do so. However, the court cannot authorize the sale of the premises free and clear of all liens, in the manner suggested, unless all the parties holding liens are made parties to the action. The City of Buffalo, the County of Erie and the Buffalo Sewer Authority are not now parties. They should be made parties either by service of a supplemental summons or by the service upon them of the appellant's answer with an appropriate summons (treating the so-called affirmative defense in the answer as a counter-claim against the holders of local tax liens; see Civil Practice Act, § 271).

The judgment of foreclosure, insofar as appealed from, should therefore be reversed and the case remitted to the County Court for further proceedings.

[fol. 45] In the Supreme Court of New York, Appellate Division—Fourth Department

Buffalo Savings Bank, Respondent,

vs.

Beverly Victory, Individually and as Admx. of the Estate of Joseph B. Victory, a k a Joseph Victory, deceased; Marilyn M. Victory; Duane B. Victory; The Western Savings Bank of Buffalo; B. & L. Motors, Inc.; David Cole d b a Dave Cole Motors, as successor in interest, etc.; The Geamatan National Bank and Trust Company of Bronxville; Agnes B. Thuman, as Executrix, etc. of Sylvester C. Thuman, deceased; Manufacturers and Traders Trust Company; the People of the State of New York; Alvin Jones, Defendants,

United States of America, Appellant.

Order—July 1, 1960

The above named United States of America, one of the defendants in this action, having appealed to the Appellate [fol. 46] Division of the Supreme Court Fourth Department, from certain parts of a judgment of the Erie County Court, entered in the office of the Clerk of the County of Erie, on the 9th day of June, 1959, and the said appeal having been argued by Mr. William Schapiro of counsel for the appellant, and by Mr. John H. Little of counsel for the respondent, and submitted by Mr. Thomas G. Rickert, counsel for Erie County Savings Bank, *amicus curiae*, and due deliberation having been had thereon

It is hereby Ordered, That the judgment of foreclosure, insofar as appealed from be, and the same hereby is, unanimously reversed on the law and in the exercise of discretion, and the case is hereby remitted to the Erie County Court for further proceedings in accordance with the opinion herein, without costs of this appeal to any party.

Per Curiam Opinion.

Enter.

Alger A. Williams.

Entered 1st day of July, 1960.

Herbert E. Wait, Clerk.

[fol. 47] Supreme Court, Appellate Division, Fourth Judicial Department

Clerk's Office, Rochester, N. Y.

I, Herbert E. Wait, Clerk of the Appellate Division of the Supreme Court in the Fourth Judicial Department, do hereby certify that the within is a true copy of the original order made by said court upon the appeal in the within entitled action or proceeding, and the whole thereof.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said Court at the City of Rochester, New York, this 1st day of July, 1960.

Herbert E. Wait, Clerk.

[fol. 48] In the County Court—Erie County

Buffalo Savings Bank, Plaintiff,

vs.

Beverly Victory, individually and as Administratrix of the Estate of Joseph B. Victory, also known as Joseph Victory, deceased; Marilyn M. Victory; Duane B. Victory; The Western Savings Bank of Buffalo; United States of America; B. & L. Motors Inc.; David Cole, doing business under the name of Dave Cole Motors, as successor in interest to David Cole and Edward Cole, doing business as Dave Cole Motors; The Gramatan National Bank and Trust Company of Bronxville; Agnes B. Thuman, as Executrix of the Last Will and Testament of Sylvester C. Thuman, deceased; Manufacturers and Traders Trust Company; The People of The State of New York; Alvin Jones, Defendants.

30 Lyth Avenue.

Judgment Reversed by Appellate Division, Decision of July 1, 1960

On the Summons and Complaint, duly filed in this action [fol. 49] and all proceedings therein and on the decision of Honorable Burke I. Burke, Erie County Judge, dated June

1959, wherein he found that the answer of the defendant, United States of America, should be stricken out and that the sum of One Thousand Five Hundred Sixty and 13/100 Dollars ($1,560.13) was due thereon to the plaintiff on March 12, 1959, that plaintiff's mortgage was and is a first lien on the mortgaged premises, that plaintiff is entitled to judgment of foreclosure and sale, and that the mortgaged premises cannot be sold in parcels.

Now, on motion of Little and Burt, attorneys for the plaintiff, it is

Ordered, Adjudged and Decreed, that the answer interposed herein by the defendant, United States of America be and the same hereby is stricken out, and it is further

Ordered, Adjudged and Decreed, that the plaintiff is entitled to have herein the sum of One Thousand Five Hundred Sixty and 13/100 Dollars ($1,560.13), the sum so due as aforesaid, with interest thereon from the 12th day of March, 1959, besides the sum of Three Hundred Twenty-seven and 90/100 Dollars ($327.90) as taxed by the Clerk of the Court and hereby adjudged to the plaintiff for costs and disbursements in this action, with interest thereon from the date hereof; and it is further

Ordered, Adjudged and Decreed, that Evan E. James, Esq., is awarded the sum of $100.00 in full of his services [fol. 50] as Guardian *ad Litem* and Designated Attorney herein, and it is further

Ordered, Adjudged and Decreed, that the mortgaged premises described in the complaint in this action as hereinafter set forth, be sold, at public auction at the westerly vestibule of the Erie County Hall, Buffalo, New York, by or under the direction of Robert W. McNulty of the Town of Orchard Park in the County of Erie, New York, who is hereby appointed referee for that purpose; that said referee give public notice of the time and place of such sale, according to law and the course and practice of this Court; that the plaintiff, or any other party to this action, may become the purchaser or purchasers on such sale; that said referee execute to the purchaser or purchasers on such sale a deed of the premises sold. That the mortgaged premises herein described be sold, subject to all local real estate taxes, assessments and water rates, which are or may become

liens on the premises at the time of the sale, together with such interest or penalties as may have lawfully accrued thereon to the date of payment, payment of which is necessary to perfect or pass clear title to the said premises on the terms hereof and of said sale;

That said referee forthwith, upon receipt of the proceeds of sale or any part thereof, deposit the same in his own name as referee, in the Liberty Bank of Buffalo and that said referee, after the delivery of said deed, pay from the [fol. 51] moneys so deposited the referee's legal fees and the lawful advertising expenses, and then to pay to the plaintiff or its attorneys the aforesaid costs, disbursements and allowances, with interest, and also the said amount hereinbefore adjudged due the plaintiff, with interest, or so much thereof as said moneys will pay, and deposit the surplus, if any, as hereinafter provided, taking receipts for all such payments and filing the same with his report of sale.

That said referee shall make a report of such sale and file it with the Clerk of Erie County; and if the proceeds of such sale be insufficient to pay the amount so reported due to the plaintiff, with interest and costs, disbursements and allowances with interest as aforesaid, that said referee specify the amount of such deficiency in his report of sale, and that the defendant, Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also know as Joseph Victory), deceased, pay the same to the plaintiff, and that the plaintiff have judgment and execution therefor, or so much thereof as the Court may determine to be just and equitable of the debt remaining unsatisfied; but if there be a surplus, then that said referee shall deposit the same, within five days after its ascertainment, with the Liberty Bank of Buffalo, to the credit of this action, but subject to the further order of the Court herein. Further ordered that the purchaser or purchasers at such sale be let into possession on production of the referee's deed or deed's. [fol. 52] That in case the plaintiff becomes the purchaser of the said mortgaged premises at said sale, or in the event that the rights of the purchaser at said sale and the terms of sale under this Judgment shall be assigned to or shall be acquired by the plaintiff and a valid assignment thereof be delivered to said referee, said referee shall not require the

plaintiff to pay in cash the entire amount bid at said sale, but shall execute and deliver to the plaintiff a deed of the premises sold upon the payment to said referee of the amounts hereinbefore specified as taxed by the Clerk of this Court and adjudged to the plaintiff for costs and disbursements, with interest thereon from the date hereof, together with the allowance hereby awarded to the plaintiff, in addition to said costs, with interest thereon from the date hereof, together with the referee's fees, advertising expenses, all of which shall be allowed to the plaintiff and applied by the said referee accordingly. If after such application and allowing the plaintiff from the amount for which the property shall have sold as aforesaid, there shall remain of the amount so bid, a surplus over and above the amount due the plaintiff, the plaintiff shall pay to said referee upon delivery to it or its assigns of said referee's deed and the amount of such surplus, and said referee shall thereupon deposit the balance in said depository as hereinbefore directed.

That said referee take the receipt of the plaintiff, or its [fol. 53] attorneys, for the amounts paid as hereinbefore directed and file same with his report of sale; that he deposit the surplus moneys, if any, with the Liberty Bank of Buffalo, within five day after the same shall have been received by him to the credit of this action to be withdrawn only on the order of this Court.

That if the proceeds of the sale be insufficient to pay the amounts so reported due to the plaintiff as aforesaid with the expenses of sale, interest, costs, allowances, that said referee specify the amount of such deficiency in his report of sale and that the defendant, Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, pay the same to the plaintiff, and that the said plaintiff have Judgment and execution therefore as hereinbefore provided; and it is further

Ordered, Adjudged and Decreed, that each and all of the defendants in this action and all persons claiming under them or any or either of them, after the filing of the notice of pendency of this action, be, and they hereby are, forever barred and foreclosed of all right, claim, lien, title, interest and equity of redemption in the said mortgaged premises and each and every part thereof.

The following is a description of the said mortgaged premises hereinbefore mentioned:

All That Tract or Parcel of Land situate in the City of Buffalo, County of Erie and State of New York, bounded and described as follows:

[fol. 54] Commencing at a point in the northerly line of Lyth Place, three hundred forty-three and two-tenths (343.2) feet westerly from its intersection with the westerly line of Jefferson Street; running thence westerly along said line of Lyth Place twenty-four and four-tenths (24.4) feet; thence northerly at right angles one hundred twenty (120) feet to a point midway between the northerly line of Lyth Place and the south line of Northland Avenue, formerly Puffer Street; thence easterly along the line midway between said lines of Lyth Place and Northland Avenue, formerly Puffer Street, twenty-four and four-tenths (24.4) feet; thence southerly at right angles one hundred twenty (120) feet of the northerly line of Lyth Place at the place of beginning.

Subject to restrictions and rights of utilities of record affecting said premises.

Together With all the right, title and interest of the mortgagor of, in and to the land lying in the bed of any street, road, avenue, lane or right of way as they now exist or formerly existed in, in front of an adjoining the said premises, and in and to all easements, riparian rights and appurtenances and all the estate and rights of the mortgagor in and to said premises.

Together With all fixtures and articles of personal [fol. 55] property, now or hereafter attached to, and used in connection with, the above described premises, all of which are covered by said mortgage.

Burke I. Burke, Erie County Judge.

Granted June 9, 1959.

O. E. Mueller, Special Deputy Clerk.

IN THE COUNTY COURT OF ERIE COUNTY

DECISION

A motion having been made herein by the plaintiff for summary judgment in favor of the plaintiff and against the defendant, United States of America, under Rule 113 of the Rules of Civil Practice, and for an Order striking out the answer interposed herein by the defendant, United States of America, on the ground that the answer has no merit and there is no defense to the cause of action set forth in the complaint of the plaintiff, and on the return day of said motion, to wit: the 12th day of March, 1959, at a Special Term of this Court, the Court having read the complaint and the answer of the defendant, United States of America, and the general answer of Evan E. James, Esq., Guardian *ad Litem* for the defendant, Marilyn M. Victory, an infant, submitting the rights of said infant to the Court, and the general answer of Evan E. James, Esq., [fol. 56] Designated Attorney for the defendant, Duane B. Victory, a member of the Armed Forces of the United States of America, submitting his rights to the Court, and having read and filed the notice of motion herein dated March 2, 1959, with proof of due service thereof, the affidavit of Evar J. Skoog, verified March 2, 1959, and the answering document of the defendant, United States of America, designated by it, "Answer to Plaintiff's Petition and Motion", and after hearing Little and Burt, John H. Little of counsel, attorneys for the plaintiff, in support of the motion, and John O. Henderson, United States Attorney, William I. Schapiro of counsel, attorney for the defendant, United States of America, in opposition thereto, and Evan E. James, Esq., Special Guardian and Designated Attorney appearing but not opposing plaintiff's motion and Messrs. Moot, Sprague, Marcy and Gulick, William H. Gage and Thomas G. Richert of counsel, attorneys for Erie County Savings Bank appearing *Amicus Curiae*, and the Court having taken proof at that time of the facts and circumstances stated in plaintiff's complaint and the plaintiff having produced proof by witnesses of the allegations contained in its complaint and none of the defendants having offered any proof in opposition thereto,

and it appearing that the summons and complaint and the *lis pendens* in this action were duly filed in the Erie County Clerk's Office on the 21st day of October, 1958, and that all of the defendants herein have been personally served with a copy of the summons and complaint within the [fol. 57] State of New York more than twenty days since, except the defendant, Duane B. Victory, a member of the Armed Forces of the United States of America, residing in the City of Springfield, Massachusetts, who was duly served more than thirty days since, and the defendant, United States of America, which was duly served more than sixty days since. That none of the defendants have appeared herein except the defendant, B. & L. Motors Inc., which has duly appeared herein by its attorney, Anthony C. Hardo, Esq.; the defendant, David Cole, doing business under the name of Dave Cole Motors, as successor in interest to David Cole and Edward Cole, doing business as Dave Cole Motors, who has duly appeared herein by his attorneys, Messrs. Cohen, Lombardo, Maisel, Blewett and Fisher; the defendant, The Gramatan National Bank and Trust Company of Bronxville, which has duly appeared herein by its attorney, David J. Goldstein, Esq.; the defendant, Agnes B. Thuman, who has duly appeared herein by her attorney, Francis J. Busteed, Esq.; the defendant, Manufacturers and Traders Trust Company, which has duly appeared herein by its attorneys, Messrs. Hodgson, Russ, Andrews, Woods & Goodyear; and the defendant, The People of the State of New York, which has duly appeared herein by its attorney, Hon. Louis J. Lefkowitz, Attorney General. That all of said defendants have waived notice of all proceedings herein except notice of sale and notice of surplus money proceedings, except the defendant, [fol. 58] The People of the State of New York, which has waived service of all papers herein, except amended complaint, notice of sale, referee's report of sale, notice of motion to confirm referee's report of sale, judgment or order thereon, surplus money proceedings, and notice of application to discontinue action, and that all of said defendants have made default in pleading except the defendant, United States of America, as aforesaid, and the defendant, Marilyn M. Victory, an infant, who has appeared and interposed a general answer by her attorney, Evan E. James, Esq.; and the defendant, Duane B.

Victory, a member of the Armed Forces of the United States of America, who has appeared and interposed a general answer by his attorney, Evan E. James, Esq.; and due deliberation having been had thereon, I find as follows:

FINDINGS OF FACT

I. That the plaintiff and the defendants, The Western Savings Bank of Buffalo, B. & L. Motors Inc., The Gramatan National Bank and Trust Company of Bronxville, and Manufacturers and Traders Trust Company, are and at all times hereinafter mentioned were domestic corporations.

II. That one Joseph B. Victory, for the purpose of securing payment to plaintiff, Buffalo Savings Bank, of Two Thousand Six Hundred Dollars ($2,600.00), with interest thereon, on or about the 5th day of April, 1946, duly executed and delivered to said plaintiff, Buffalo Savings Bank, [fol. 59] his bond dated that day whereby he promised to pay to plaintiff, Buffalo Savings Bank, or its assigns, the principal sum of Two Thousand Six Hundred Dollars ($2,600.00) in manner following:

> "Twenty-five Dollars ($25.00) on the 10th day of October, 1946, and Twenty-five Dollars ($25.00) quarter-annually thereafter until the 10th day of July, 1949, when the balance of said principal sum then unpaid shall be due and payable, together with interest to be computed at the rate of five per centum (5%) per annum from the date hereof, and paid quarterly on the 10th days of January, April, July and October in each year, on all sums from time to time remaining unpaid, then this obligation to be void, otherwise to remain in full force and virtue."

III. That said bond also contained a further provision that the whole of said principal sum, or any part thereof, should at the option of the obligee become due and payable upon the happening of any of the events specified in a certain mortgage bearing even date therewith given to secure said bond and that all the covenants and agreement made by said obligor in said mortgage covering the premises therein described and collateral to said bond were made a part of said bond.

IV. That as collateral security for payment of said indebtedness, said Joseph B. Victory on the same day duly executed and delivered to the plaintiff a mortgage dated [fol. 60] that day whereby he mortgaged to said Buffalo Savings Bank, its successors and assigns, the following described premises:

> All That Tract or Parcel of Land situate in the City of Buffalo, County of Erie and State of New York, bounded and described as follows:
>
> Commencing at a point in the northerly line of Lyth Place, three hundred forty-three and two-tenths (343.2) feet westerly from its intersection with the westerly line of Jefferson Street; running thence westerly along said line of Lyth Place twenty-four and four-tenths (24.4) feet; thence northerly at right angles one hundred twenty (120) feet to a point midway between the northerly line of Lyth Place and the south line of Northland Avenue, formerly Puffer Street; thence easterly along the line midway between said lines of Lyth Place and Northland Avenue, formerly Puffer Street, twenty-four and four-tenths (24.4) feet; thence southerly at right angles one hundred twenty (120) feet to the northerly line of Lyth Place at the place of beginning.

V. That the said mortgage contained the same conditions as the said bond and the further condition that in case of default in the payment of said sum of money, or any part thereof, or the interest that might grow due thereon, the said mortgagee, the plaintiff Buffalo Savings Bank, was empowered to sell the mortgaged premises according to law.

[fol. 61] VI. That the said mortgage was duly recorded in the office of the Clerk of the County of Erie on the 5th day of April, 1946, at 2:35 o'clock P. M., in Liber 3626 of Mortgages at page 139. That the mortgage recording tax imposed thereon by law was duly paid.

VII. That the said mortgage contained the following covenants:

> "Second. • • • In event of foreclosure of this mortgage or other transfer of title to the mortgaged prop-

erty in extinguishment of the debt secured hereby, all right, title, and interest of the Mortgagor in and to any insurance policies then in force shall pass to the purchaser or grantee.

"Fifth. That the mortgagor will pay all taxes, assessments, water rates and other governmental or municipal charges, fines or impositions, and in default thereof the mortgagee may pay the same.

"Sixth. That the whole of said principal sum shall become due immediately after default in the payment of any installment of principal or of interest or after default in the payment of any tax, water rate or assessment for thirty days after notice and demand.

"Ninth. That the holder of this mortgage, in any action to foreclose it, shall be entitled to the appointment of a receiver without notice, as a matter of right, [fol. 62] without consideration of the value of the premises as security for the amounts due the mortgagee, or the solvency of any person or persons liable for the payment of such amounts.

"Eleventh. That in the event of any default on the part of the Mortgagor hereunder, while said Mortgagor occupies said premises, the Mortgagor agrees to pay the Mortgagee on demand, as a reasonable monthly rental for the premises, an amount at least equivalent to one-twelfth of the aggregate of the installments of interest payable in the then current year, plus the actual amount of the annual taxes, assessments, water rates and insurance premiums for such year and, upon default on the payment of any sum due as such rental, the Mortgagee shall have the right to institute summary proceedings to obtain possession of said premises in the manner provided by Article 83 of the Civil Practice Act for the recovery of demised premises after a default in the payment of rent.

"Fifteenth. That in any action to foreclose this mortgage said premises may be sold in one parcel."

VII. That thereafter and on or about the 13th day of February, 1954, said Joseph B. Victory (also known as Joseph Victory) died, intestate, at the City of Buffalo, New York, a resident of Erie County, New York, leaving him surviving as his only distributees the defendant, Bev- [fol. 63] erly Victory, his widow, of full age, Marilyn M. Victory, a daughter, at that date an infant twelve (12) years of age, and Duane B. Victory, a son, at that date an infant nineteen (19) years of age. That thereafter and on or about the 12th day of September, 1956, Letters of Administration upon the estate of said decedent were issued by the Surrogate of Erie County to the defendant, Beverly Victory, who is still acting as such Administratrix.

That no estate or transfer tax proceedings upon the estate of said decedent are on file in the office of said Surrogate of Erie County.

IX. That the defendant, Marilyn M. Victory, is now an infant over the age of fourteen (14) years and resides at No. 30 Lyth Avenue in the City of Buffalo, New York, with her mother, the defendant, Beverly Victory, who is the person having the care and charge of said infant. That the defendant, Duane B. Victory, is now an adult but is a member of the Armed Forces of the United States of America.

X. That the said defendants and each of them have failed to comply with the conditions of said bond and mortgage in that they have failed to pay the 1958 Erie County tax levied by said County against the premises covered by said mortgage and the 1957 and 1958 City taxes levied by the City of Buffalo against the premises covered by said mortgage and the 1958 City of Buffalo Sewer rent levied by the Buffalo Sewer Authority against the premises covered by [fol. 64] said mortgage. That more than thirty days have elapsed since due demand has been made for the payment of said taxes and sewer rent and said taxes and sewer rent remain unpaid.

XI. That the said defendants, and each of them, have failed to comply with the conditions of said bond and mortgage in that they have failed to pay the principal and interest due and called for in said bond and mortgage, to wit: the installments of principal and interest due on

the 10th days of April, July and October, 1958, and on the 10th day of January, 1959.

XII. That in and by the terms of said bond and mortgage, the full amount thereof remaining unpaid, to wit: One Thousand Four Hundred Seventy-three and 75/100 Dollars ($1,473.75) is now due and payable because of the default by the defendants in paying said taxes and sewer rent and said installments of principal and interest and that plaintiff, Buffalo Savings Bank, has elected by reason thereof and under the terms and conditions set forth in said bond and mortgage that the whole of said principal sum remaining unpaid, secured by said bond and mortgage, together with the interest thereon, should immediately, as elected, be due and payable.

XIII. That there is due plaintiff on said bond and mortgage the principal sum of One Thousand Four Hundred Seventy-three and 75/100 Dollars ($1,473.75) with interest at the rate of five per centum (5%) per annum from the 10th day of January, 1958.

[fol. 65] XIV. That a recapitulation of the amount due plaintiff on said bond and mortgage is as follows:

Principal of bond and mortgage due and unpaid	$1,473.75
Interest thereon from January 10, 1958, to March 12, 1959, at the rate of five per centum (5%) per annum	86.38
Amount due plaintiff March 12, 1959	$1,560.13

XV. That the defendant, Marilyn M. Victory, an infant, has no defense to this action.

XVI. That the defendant, Duane B. Victory, a member of the Armed Forces of the United States of America, has no defense to this action.

XVII. That no other action or proceeding has been commenced, at law or otherwise, for the recovery of the sum secured by the said bond and mortgage.

XVIII. That the interests or liens, if any, of each of the defendants accrued, subsequently to the lien of plaintiff's mortgage, and that all such interests or liens, if any,

are subject and subordinate to the lien of plaintiff's mortgage.

XIX. That the defendant, The People of the State of New York, is made a party defendant herein because of the fact that the transfer tax, if any there be due, upon the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, is unpaid and to the extent thereof constitutes a lien on the premises above described and for no other reason.

[fol. 66] XX. That the defendant, United States of America, is made a party defendant herein because said United States of America filed a notice of tax lien (No. 1592) against said Joseph B. Victory (also known as Joseph Victory) on January 15, 1953, in the office of the Clerk of Erie County, New York, for the sum of $857.07.

XXI. That the plaintiff, Buffalo Savings Bank, has advanced no money for the payment of outstanding real estate taxes or assessments, water meter charges, sewer rents or insurance premiums against the mortgaged premises.

XXII. That the defendant, Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, is liable to the plaintiff for the amount of any deficiency arising on the foreclosure sale herein.

XXIII. That the answer of the defendant, United States of America, raises no issue of fact.

Conclusions of Law

I. That the plaintiff's mortgage is a valid and subsisting lien upon the property described in the complaint for the amount hereinbefore found due to the plaintiff, and that the rights, interests, liens and claims of the respective defendants, if any, are subject and subordinate thereto.

II. That the plaintiff is entitled to an order striking out the answer of the defendant, United States of America, pursuant to the provisions of Section 113 of the Civil Practice Act.

[fol. 67] III. That the plaintiff is entitled to judgment of foreclosure and sale of said property, free and clear of all rights, interests, liens and claims of the defendants and each of them, adjudging to the plaintiff the sum of One Thousand Five Hundred Sixty and 13/100 Dollars ($1,

560.13), with interest thereon from the 12th day of March, 1959, and directing the payment thereof and the costs and expenses of this action and of such sale out of the proceeds of the sale, and containing other appropriate directions, terms and provisions, with provision for a deficiency judgment against the defendant, Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased.

IV. That said judgment of foreclosure and sale shall contain a provision directing the referee to sell said premises subject to all taxes, assessments and water rates, which are or may become liens on the premises at the time of the sale, together with such interest or penalties which may have lawfully accrued thereon.

V. That the judgment also provide that the premises be sold in one parcel.

VI. That the plaintiff should be granted costs and disbursements in this action.

I order and direct that judgment be entered accordingly.

Dated: Buffalo, New York, June 9, 1959.

Burke I. Burke, Erie County Judge.

[fol. 68] In the County Court of Erie County

Little & Burt, John F. Little, Esq., of Counsel Attorneys for Plaintiff.

John O. Henderson, Esq., United States Attorney, William I. Shapiro, Esq., Asst. U. S. Atty. of Counsel, Attorney for Defendant, United States of America.

Evan E. James, Esq., Guardian *ad litem* for Defendant, Marilyn M. Victory, and designated attorney for Defendant Duane B. Victory.

Moot, Sprague, Marcy & Gulick, William H. Gage and Thomas G. Rickert, Esqs., of Counsel, Attorneys for Erie County Savings Bank, *Amicus Curiae*.

Opinion of Hon. Burke I. Burke, Dated May 29, 1959

This is a motion, in a foreclosure action, to strike out the answer of Defendant, United States of America, and for summary judgment of foreclosure and sale.

As Plaintiff requests a judgment of sale, subject only to local estate taxes, the more substantial question presented is whether the determination in United States vs. New Britain, 347 U. S. 81 (1954), with its resulting doctrine of circular priority, is applicable.

Under most state laws, including New York, real property taxes rank above pre-existing liens and mortgages. In the New Britain case the U. S. Supreme Court held that real property taxes, assessed after a federal tax is as- [fol. 69] sessed, are subordinate to the federal tax lien. Thus there arises a circular priority in which:

a. The earlier mortgage outranks the federal tax lien (federal and state tax law).

b. The federal tax lien outranks the later real property tax (federal law).

c. The later real property tax outranks the mortage (state law.)

The U. S. Attorney's brief affords the following example of the mechanics of circular priority:

"A Mortgagee forecloses. The liens, ranked in order of time from oldest to newest, are:

1. The mortgage being foreclosed	$5,000.
2. Federal tax lien	2,000.
3. County tax lien	1,000.

Assume that a sale is ordered free and clear of the liens, and a purchaser buys the property for $6,000. The result required by the New Britain case would be as follows: $5,000. is set aside for the mortgage. The remaining $1,000. of surplus money is paid on the federal tax lien, which has been foreclosed. The county lien is paid in full out of the amount set aside for the mortgage, so that the mortgage ultimately gets $4,000."

Plaintiff contends the rule does not apply here because of [fol. 70] the different type of sale permitted by Section 1087 of the New York Civil Practice Act. Defendant, United States of America, denies such contention.

The complaint alleges defaults in payment of principal and interest, and requests sale of the mortgaged premises to satisfy foreclosure costs and expenses and amounts alleged due and unpaid on the bond and mortgage. The complaint further alleges that Plaintiff may be required to pay real estate taxes and assessments affecting the premises and asks that if such sums are paid, they be included. The complaint further alleges that the United States of America is made a Defendant by reason of a tax lien filed against Joseph Victory on January 15, 1953 in the amount of $857.07.

The Defendant, United States of America, in its answer, denies knowledge or information coeerning the mortgage transaction; admits existence of its tax lien; denies said lien is subordinate to any other liens against the premises; and denies said lien is subordinate to any claim by Plaintiff for payment of real estate taxes and assessments that Plaintiff may choose to make.

The Defendant, United States of America, as an affirmative defense, alleges, (1) that there is an unpaid balance of $687.07 plus interest on its tax lien; (2) that the interest and liens of all Defendants are inferior to said tax lien; (3) that the judgment of foreclosure and sale, if [fol. 71] granted, require the referee to pay from the proceeds of sale, the amount of said tax lien prior to the payment of the lien of any other Defendant.

The present motion was noticed to strike the answer of Defendant, United States of America, to obtain summary judgment of foreclosure and sale, and to include in such judgment a direction that the premises be sold subject to local real property taxes and assessments. The moving papers include an affidavit by an officer of Plaintiff, stating Plaintiff had not advanced nor would advance any sums for payment of real estate taxes and assessments.

On the return date of the motion, Defendant United States of America, filed with the court and served on Plaintiff's attorneys an instrument entitled, "Answer to Plaintiff's petition and motion." Therein Defendant, United States of America, re-alleges a balance of $687.07 due on its tax lien and that said lien is superior to all local tax liens; alleges that paragraph seven of its answer controverts the relief sought by Plaintiff and that the motion therefore should be denied.

In the event judgment is granted, Defendant's answer alleges such judgment should direct a sale subject to the United States tax lien, if the judgment directs a sale subject to local tax liens; or that such judgment direct payment of the United States tax lien immediately after referee's expenses, legal costs and disbursements, principal [fol. 72] and interest due on Plaintiff's mortgage, amounts due on other liens choate prior to the United States tax lien, if such judgment directs a sale free and clear of local tax liens."

On the return date of the motion, Plaintiff, without objection by Defendant, United States of America, submitted proof as to the existence and extent of the mortgage lien for principal and interest, and that it had not advanced nor would advance any sums for real estate taxes or assessments affecting the premises.

Erie County Savings Bank requested and was granted permission to appear and file a brief as *amicus curiae*.

Defendant, United States of America, apparently does not seriously oppose the motion for summary judgment. It does maintain that a sale of premises subject to unpaid local taxes should be a sale subject also to the government's tax lien or, in the alternative, that if the property is sold free and clear of all liens and encumbrances, the federal government's priority be recognized.

With respect to the motion for summary judgment, the court is of the opinion that, by reason of the evidence submitted on the return date of the motion, the complaint and answer now raise no issue of fact and that the effect of the answer is to allege (1) priority of the lien of defendant, United States of America, and (2) that the order sought by Plaintiff is contrary to law.

[fol. 73] Conclusions of law are insufficient to withstand a motion for summary judgment and the court has power to act, as it did in Aquilino v United States, 3 New York 2nd, 511, where the facts were admitted and the only issue presented, the relative priority of the United States Government and other lien holders. The priority of liens and whether the sale is to be made subject to any local taxes and assessments are matters for the court to determine on application for judgment. Accordingly Plaintiff's motion

for summary judgment is granted, there remaining the form of the order directing sale of the mortgaged premises.

Section 1087 of the New York Civil Practice Act, referring to real property foreclosure procedures, reads:

> 1087: "Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. The provisions of this sec- [fol. 74] tion shall not apply to any judgment in an action wherein any municipal corporation of this state is the plaintiff and the purchaser at the foreclosure sale thereunder."

Under this section it is within the discretion of the court to direct the referee to pay real property taxes from the proceeds of sale, or to direct the property be sold subject to such taxes.

The New Britain case does not mandate a sale directing payment of taxes by the referee. As Plaintiff notes in its brief, the United States prefers this procedure so that the referee may be required to bring the proceeds of sale into court, and then directed to distribute them in accordance with the priority established in the New Britain case.

In its answer to the complaint, Defendant, United States of America, prays that the referee be required to pay from the proceeds of sale the tax lien of the United States. But in its answer to the application for summary judgment, Defendant, United States of America, asks a sale in one of two ways: (1) free and clear of all liens, with the federal lien paid pursuant to the New Britain rule, (2) subject to local real estate taxes, if also subject to federal tax liens.

As to the latter proposition advanced by Defendant, United States of America, it has been brought to the court's

attention that the only appearances in the New Britain [fol. 75] case were on behalf of the United States and the City of New Britain; that the mortgagee was not represented; that the decision was a determination of tax priorities without an opportunity for argument upon the extensive legal and social ramifications affecting mortgagors and mortgagees; and that the Connecticut decision reversed was one directing distribution of the proceeds of sale.

The New Britain case did not specifically involve the issue presented here, whether the court in its discretion may direct that the judgment contain a provision for sale by the referee subject to local taxes and assessments, as set forth in Section 1087 of the New York Civil Practice Act. And this court is unwilling to expand the effect of said decision.

Accordingly, it is directed that the clerk enter judgment for the relief demanded in the complaint, and that said judgment provide for sale by the referee, subject to unpaid local taxes and assessments. Submit order.

Dated: Buffalo, New York, May 29, 1959.

Burke I. Burke, Erie County Judge.

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* * * * * * *

[fol. 76] In the County Court of Erie County

Complaint

The plaintiff alleges on information and belief:

First: That the plaintiff, Buffalo Savings Bank; is a domestic banking corporation having its principal place of business at No. 545 Main Street in the City of Buffalo, New York.

That the defendant, The Western Savings Bank of Buffalo, is a domestic banking corporation having its principal place of business in the City of Buffalo, New York.

[fol. 77] That the defendant, B. & L. Motors Inc., is a domestic corporation having its principal place of business in the City of Buffalo, New York.

That the defendant, The Gramatan National Bank and

Trust Company of Bronxville, is a domestic banking corporation having its principal place of business in the Village of Bronxville, New York.

That the defendant, Manufacturers and Traders Trust Company, is a domestic banking corporation having its principal place of business in the City of Buffalo, New York.

Second: That heretofore, and on or about the 5th day of April, 1946, one Joseph B. Victory, since deceased, executed under his hand and seal, and delivered to the plaintiff, a bond bearing date on that day with a condition thereunder written, in substance, that the obligor in said bond named, his distributees, executors or administrators, should pay or cause to be paid to the obligee in said bond named, its certain attorney, successors or assigns, the sum of Twenty-Six Hundred Dollars ($2600.00) in manner following:

> "Twenty-five Dollars ($25.00) on the 10th day of October, 1946, and Twenty-five Dollars ($25.00) quarterannually thereafter until the 10th day of July, 1949, when the balance of said principal sum then unpaid shall be due and payable, together with interest to be computed at the rate of five per centum (5%) per [fol. 78] annum from the date hereof, and paid quarterly on the 10th days of January, April, July and October in each year, on all sums from time to time remaining unpaid, then this obligation to be void, otherwise to remain in full force and virtue."

That the said bond contained the further provision that the whole of said principal sum, or any part thereof, should forthwith or thereafter at the option of said obligee become due and payable upon the happening of any of the events specified in a certain mortgage bearing even date therewith, given to secure said bond, and that all the covenants, agreements, terms and conditions of said mortgage were thereby made a pa of said bond or obligation with the sam force and effect as if therein set forth at length.

Third: That the said Joseph B. Victory, since deceased, to secure the payment of the principal and interest mentioned in said bond, did, at the same time, execute under his hand and seal, and deliver to said plaintiff, a mortgage bearing even date with the bond, whereby he granted, released and conveyed unto said plaintiff, in fee, certain

lands and real estate, situate in the City of Buffalo, County of Erie and State of New York, which premises were described in said mortgage as follows:

All That Tract or Parcel of Land situate in the City of Buffalo, County of Erie and State of New York, bounded and described as follows:

Commencing at a point in the northerly line of Lyth [fol. 79] Place three hundred forty-three and two-tenths (343.2) feet westerly from its intersection with the westerly line of Jefferson Street; running thence westerly along said line of Lyth Place twenty-four and four-tenths (24.4) feet; thence northerly at right angles one hundred twenty (120) feet to a point midway between the northerly line of Lyth Place and the south line of Northland Avenue, formerly Puffer Street; thence easterly along the line midway between said lines of Lyth Place and Northland Avenue, formerly Puffer Street, twenty-four and four-tenths (24.4) feet; thence southerly at right angles one hundred twenty (120) feet to the northerly line of Lyth Place at the place of beginning.

Subject to restrictions and rights of utilities of record affecting said premises.

Together With all the right, title and interest of the mortgagor of, in and to the land lying in the bed of any street, road, avenue, lane or right of way as they now exist or formerly existed in, in front of or adjoining the said premises, and in and to all easements, riparian rights and appurtenances and all the estate and rights of the mortgagor in and to said premises.

Together With all fixtures and articles of personal property now or hereafter attached to, and used in connection with, the above described premises, all of which are covered by said mortgage.

[fol. 80] Fourth: That the said mortgage contained the same conditions as the said bond and in case of default in the payment of the said sum of money, or of any part thereof, or the interest that might grow due thereon, or in the payment of taxes or assessments, the said plaintiff

was thereby empowered to sell the said mortgaged premises according to law.

Fifth: That the said mortgage contained the following clauses, to wit:

"Second. * * * In event of foreclosure of this mortgage or other transfer of title to the mortgaged property in extinguishment of the debt secured hereby, all right, title, and interest of the Mortgagor in and to any insurance policies then in force shall pass to the purchaser or grantee.

"Fifth. That the mortgagor will pay all taxes, assessments, water rates and other governmental or municipal charges, fines or impositions, and in default thereof the mortgagee may pay the same.

"Sixth. That the whole of said principal sum shall become due immediately after default in the payment of any installment of principal or of interest or after default in the payment of any tax, water rate or assessment for thirty days after notice and demand.

"Ninth. That the holder of this mortgage, in any action to foreclose it, shall be entitled to the appointment of a receiver, without notice, as a matter of right, [fol. 81] without consideration of the value of the premises as security for the amounts due the mortgagee, or the solvency of any person or persons liable for the payment of such amounts.

"Eleventh. That in the event of any default on the part of the Mortgagor hereunder, while said Mortgagor occupies said premises, the Mortgagor agrees to pay the Mortgagee on demand, as a reasonable monthly rental for the premises, an amount at least equivalent to one-twelfth of the aggregate of the installments of interest payable in the then current year, plus the actual amount of the annual taxes, assessments, water rates and insurance premiums for such year and, upon default in the payment of any sum due as such rental, the Mortgagee shall have the right to institute summary proceedings to obtain possession of said premises in the manner provided by Article 83 of the Civil Practice Act for the re-

covery of demised premises after a default in the payment of rent.

"Fifteenth. That in any action to foreclose this mortgage said premises may be sold in one parcel."

Sixth: That the said mortgage was duly recorded in the office of the Clerk of the County of Erie on the 5th day of April, 1946, at 2:35 o'clock, P. M., in Liber 3626 of Mortgages at page 139.

[fol. 82] Seventh: That thereafter and on or about the 13th day of February, 1954, said Joseph B. Victory (also known as Joseph Victory) died, intestate, at the City of Buffalo, New York, a resident of Erie County, New York, leaving him surviving as his only distributees the following named defendants, to wit: his widow, Beverly Victory, of full age, Marilyn M. Victory, a daughter at that date an infant twelve (12) years of age, and Duane B. Victory, a son, at that date an infant nineteen (19) years of age. That thereafter and on or about the 12th day of September, 1956, Letters of Administration upon the estate of said decedent were issued by the Surrogate of said Erie County to the defendant Beverly Victory who is still acting as such Adminstratrix.

That no estate or transfer tax proceedings upon the estate of said decedent are on file in the office of said Surrogate of Erie County.

Eighth: That the defendant, Marilyn M. Victory, is an infant over the age of fourteen (14) years and resides at Number 30 Lyth Avenue in the City of Buffalo, New York, with her mother, the defendant, Beverly Victory, she being the person having the care and charge of said infant.

Ninth: That on or about the 1st day of January, 1958, there became due to the County of Erie certain taxes levied by said County against the premises covered by said mortgage, and that on or about the 1st days of July, 1957 and 1958, there became due to the City of Buffalo certain taxes levied by said City against the premises [fol. 83] covered by said mortgage, and that on or about the 1st day of July, 1958, there became due to the City of Buffalo certain sewer rents levied by the Buffalo Sewer Authority against the premises covered by

said mortgage. That more than thirty days have elapsed since due demand has been made for the payment of said taxes and sewer rents and said taxes and sewer rents remain unpaid.

Tenth: That by reason thereof and in and by the terms of plaintiff's said bond and mortgage, the full amount thereof, remaining unpaid, to wit: One Thousand Four Hundred Seventy-three and 75/100 Dollars ($1,473.75) is now due and payable, and that the plaintiff has elected and does hereby elect that the whole of the said principal sum secured by the said bond and mortgage, remaining unpaid, together with the interest thereon, shall immediately be and became due and payable.

Eleventh: That in and by the terms of said bond and mortgage, the full amount thereof, remaining unpaid, to wit: One Thousand Four Hundred Seventy-three and 75/100 Dollars ($1,473.75) is now due and payable, the defendants having failed and neglected to pay the installments of interest and principal due thereon, on the 10th days of April, July and October, 1958, and that the plaintiff has elected and does hereby elect, by reason thereof, and under the terms and conditions set forth in said bond and mortgage, that the whole of the principal sum secured by [fol. 84] the said bond and mortgage, remaining unpaid together with the interest thereon, shall immediately be and become due and payable.

Twelfth: That by reason thereof and in and by the terms of plaintiff's said bond and mortgage, the full amount thereof, remaining unpaid, to wit: One Thousand Four Hundred Seventy-three and 75/100 Dollars ($1,473.75) is now due and payable, and that the plaintiff has elected and does hereby elect that the whole of the said principal sum secured by the said bond and mortgage, remaining unpaid, together with the interest thereon, shall immediately be and become due and payable.

Thirteenth: That the plaintiff is now the sole, true and lawful owner and holder of said bond and mortgage. That of the moneys secured to be paid by said bond and mortgage there is now due and remaining unpaid the sum of One Thousand Four Hundred Seventy-three and 75/100 Dollars ($1,473.75) with interest thereon at the rate of

Five per centum (5%) per annum from the 10th day of January, 1958, and that no action has ever been brought, instituted or taken to recover the moneys so, as aforesaid, due and unpaid on the said bond and mortgage or any part thereof.

Fourteenth: That The People of the State of New York is made a party defendant herein because of the fact that the transfer tax, if any there be due, upon the Estate of Joseph B. Victory (also know as Joseph Victory),—de- [fol. 85] ceased, is unpaid and to the extent thereof constitutes a lien on the premises above described and for no other reason.

Fifteenth: That the United States of America is named as a party defendant herein because said United States of America filed a notice of tax lien (No. 1592) against said Joseph B. Victory (also know as Joseph Victory) on January 15, 1953, in the office of the Clerk of Erie County, New York, for the sum of $857.07.

Sixteenth: That in order to protect its security the plaintiff may be compelled during the pendency of this action to pay taxes, assessments, water rates, water meter charges, sewer rents and insurance premiums, if any there be, and other charges affecting the premises, and the plaintiff requests that any sum so paid by it shall be added to the sum otherwise due and be deemed secured by the said mortgage and adjudged a valid lien on the premises herein described.

Seventeenth: That the defendants and each of them, have, claim to have, or may have, some interest in or lien upon the mortgaged premises, which said interests in or liens upon said mortgaged premises, if any, have accrued subsequently to the lien of the plaintiff's mortgage and or are inferior thereto.

Eighteenth: That the plaintiff demands judgment in this action establishing the amount due and unpaid on said bond and mortgage, together with any moneys advanced and paid pursuant to any term or provision of the bond and [fol. 86] mortgage set forth herein, or to protect the lien of said mortgage together with the taxes, sewer rents, water charges, insurance and all other charges and liens thereon to be paid, and that said mortgaged premises be sold to satisfy the same, and the costs and expenses of this

action, and of such sale, and that the defendants in this action, and all persons claiming, or to claim by, through or under them, or any of them, subsequent to the commencement of this action, be forever barred and foreclosed of and from all equity of redemption, right, title, lien, interest, claim and demand of, in and to the said mortgaged premises, and every part thereof, and if the amount arising from such sale be insufficient to pay the amount due and unpaid on said bond and mortgage and the costs and expenses of this action, and of such sale, that the defendant, Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, may be ajudged to pay the plaintiff the amount of such deficiency, and that the plaintiff may have such other or further relief, or both, in the premises as this Court shall deem just and proper.

Little and Burt, Attorneys for Plaintiff.

(Verified by Ray F. Eisenhardt, Vice President, on October 21st, 1958.)

[fol. 87] In the County Court of Erie County

Answer of United States of America

The defendant United States of America by John O. Henderson, United States Attorney in and for the Western District of New York, for its answer to the complaint herein:

1. Denies knowledge or information sufficient to form a belief as to the allegations contained in paragraphs "First" through "Fourteenth", both inclusive of the plaintiff's complaint.

2. Admits the allegations contained in paragraph "Fifteenth" of the plaintiff's complaint.

3. Denies the allegations contained in paragraphs "Sixteenth" and "Eighteenth" of the plaintiff's complaint.

4. As to the allegations contained in paragraph "Seventeenth" of the plaintiff complaint, admits that the United States has a lien upon the mortgaged premises; denies

that the lien of the United States is subordinate to any lien asserted by the plaintiff on account of the plaintiff's payment of taxes, assessments, water rights, water meter charges, sewer rents, insurance premiums and other charges affecting the premises; and denies knowledge or information sufficient to form a belief as to the remaining allegations of that paragraph.

For a Separate and Affirmative Defense, Defendant Alleges:

5. The defendant United States of America has outstand-[fol. 88] ing against the premises sought to be foreclosed tax lien Number 6-4275 in the amount of $857.07 filed in the office of the Clerk of Erie County at Buffalo, New York, on January 19, 1953, of which $689.07 plus interest remains unpaid and is due the United States.

6. Upon information and belief the interest in and liens upon the mortgaged premises, if any, of all other defendants are inferior to the aforesaid tax lien of the United States.

7. All unpaid taxes, assessments, water rights, water meter charges, sewer rents, insurance premiums and other charges affecting the premises (hereinafter collectively referred to as "unpaid taxes and other charges") and all liens for the same, if any, are inferior to the aforesaid tax lien of the United States.

8. The lien, if any, asserted by the plaintiff on account of the plaintiff's payment of unpaid taxes and other charges is inferior to the aforesaid tax lien of United States.

9. Plaintiff, in its complaint, demands that the aforesaid unpaid taxes and other charges, and any and all liens for the same, and any lien asserted by plaintiff on account of the plaintiff's payment of the same, be satisfied and paid out of the proceeds of the foreclosure sale prior to any payment to the United States, notwithstanding that the said unpaid taxes and other charges, and any and all liens for the same, and any lien asserted by plaintiff on account of the plaintiff's payment of the same are inferior to the aforesaid tax lien of the United States.

[fol. 89] Wherefore the defendant United States of America prays that:

(1) The judgment of foreclosure and sale expressly requires the referee to pay out of the proceeds of sale the said tax lien of the United States plus interest prior to payment of the said unpaid taxes and other charges, or any and all liens for the same, or any lien asserted by the plaintiff on account of its payment of the same.

(2) The referee pay out of the proceeds of sale the said tax lien of the United States plus interest prior to the payment of the lien of any other defendant in this proceeding.

Dated, Buffalo, New York, January 5, 1959.

John O. Henderson, United States Attorney in and for the Western District of New York, Attorney for Defendant United States of America.

[fol. 92] IN THE COUNTY COURT OF ERIE COUNTY

NOTICE OF MOTION TO STRIKE ANSWER AND FOR JUDGMENT—Dated March 2, 1959

Sirs:

Please Take Notice that on the pleadings herein on the annexed affidavit of Evar J. Skoog, verified March 2nd, 1959, and on all the proceedings had herein, the undersigned will move this Court, pursuant to Rule 113 of the Rules of Civil Practice, at a Special Term, Part I thereof, to be held in and for the County of Erie, at the Erie County Hall in the City of Buffalo, New York, on the 12th day of March, 1959, at ten o'clock in the forenoon of that day or as soon thereafter as counsel can be heard, for an order striking out the answer of the defendant, United States of America, and directing that this action shall proceed in the usual manner to judgment of foreclosure and sale, which said judgment shall provide that the premises shall be sold free and clear of the tax lien filed by the United States of America but subject to all real property taxes and assessments, and for such other and further relief as to the Court may seem just and proper.

Please Take Further Notice that answering affidavits

to be read on this motion must be served at least five (5) days before the return day hereof.

Dated: Buffalo, New York, March 2nd, 1959.

Yours, etc., Little and Burt, Attorneys for Plaintiff.

[fol. 93] To: Hon. John O. Henderson, Attorney for Defendant, United States of America. Evan E. James, Esq., Guardian ad Litem for the Defendant Marilyn M. Victory, and Designated Attorney for the Defendant, Duane B. Victory.

AFFIDAVIT OF EVAN J. SKOSS IN SUPPORT OF MOTION

STATE OF NEW YORK,
County of Erie, City of Buffalo, ss:

EVAN J. SKOSS, being duly sworn, deposes and says that he is a Vice-President of the plaintiff, Buffalo Savings Bank, and is in charge of all mortgage loans made by said plaintiff, Buffalo Savings Bank. That deponent has personal knowledge of all of the facts hereinafter stated.

That this is an action to obtain the foreclosure of a mortgage given by Joseph B. Victory, since deceased, to the plaintiff, Buffalo Savings Bank, in the sum of Twenty-six Hundred Dollars ($2600.00), dated April 5, 1946, and recorded in the Erie County Clerk's Office on the 5th day [fol. 94] of April, 1946, in Liber 3626 of Mortgages at page 139. The *lis pendens* in this action was filed in the Erie County Clerk's Office on October 21, 1958. All of the defendants have been personally served with a copy of the summons and complaint more than twenty days since, except the defendant, Duane B. Victory, a member of the Armed Forces of the United States of America, residing in the City of Springfield, Massachusetts, who was served more than thirty days since, and the defendant United States of America, which has been served with a copy of the summons and complaint more than sixty days since. The defendant, Marilyn M. Victory, has interposed an answer by her Guardian *ad Litem*, Evan E. James Esq. in the usual form for Guardians *ad Litem* submitting the rights of said infant to the Court for such relief as may be just and equitable in the premises; the defendant, Duane

B. Victory, a member of the Armed Forces of the United States of America, has interposed an answer in the same form by his Designated Attorney, Evan E. James, Esq.; and the defendant, United States of America, has interposed an answer. No other defendant has answered.

That the complaint in this action alleges that the unpaid balance of plaintiff's mortgage in the sum of One Thousand Four Hundred Seventy-three and 75 100 Dollars ($1,473.75), with interest at the rate of five per centum (5%) per annum from the 10th day of January, 1958, [fol. 95] is now due and payable because the defendants have failed to pay the installments of interest and principal due on said mortgage pursuant to its terms on the 10th days of April, July, and October, 1958, and because the 1958 County tax, the 1957 and 1958 City taxes, and the 1958 Sewer rent on the mortgaged premises remain unpaid. Said complaint asks for judgment of foreclosure and sale in the usual form.

That the answer of the defendant, United States of America, does not controvert any of the foregoing allegations of plaintiff's complaint. Said answer merely states that the United States of America has a lien on the mortgaged premises by reason of having filed in the Erie County Clerk's Office on January 15, 1953, a tax lien in the sum of Eight Hundred Fifty-seven and 7 100 Dollars ($857.07) against said Joseph B. Victory, the mortgagor and then owner of the mortgaged premises, which lien it claims is superior to any lien asserted by the plaintiff on account of the plaintiff's payment of taxes, assessments, water rates, water rights, water meter charges, sewer rents, insurance premiums and other charges affecting the premises or any lien which the plaintiff may assert for amounts advanced for the payment of said items after the institution of this foreclosure action. Said answer does not claim said tax lien is superior to the principal and interest due on plaintiff's mortgage.

The defendant, United States of America, prays for relief:

[fol. 96] (1) The judgment of foreclosure and sale expressly requires the referee to pay out of the proceeds of sale the said tax lien of the United States plus interest prior to payment of the said unpaid taxes

and other charges, or any and all liens for the same, or any lien asserted by the plaintiff on account of its payment of the same.

(2) The referee pay out of the proceeds of sale the said tax lien of the United States plus interest prior to the payment of the lien of any other defendant in this proceeding.

The plaintiff has not advanced any sums for taxes, assessments, water rates, water rights, water meter charges, sewer rents, insurance premiums and other charges affecting the premises and does not claim a lien on the mortgaged premises for any such amount so advanced. The plaintiff has no intention of advancing any moneys for said taxes, assessments, water rates, water rights, water meter charges, sewer rents, insurance premiums and other charges affecting the premises between now and the entry of judgment of foreclosure and sale in this matter. Plaintiff asks only for judgment of foreclosure and sale for the amount of the unpaid principal and interest due on the mortgage, plus the costs and disbursements of this action. There is, therefore, no controversy between the plaintiff and the defendant, United States of America, and said answer of the defendant, United States of America, raises no issues.

[fol. 97] That the deponent does not believe there is any merit to the answer of the defendant, United States of America.

Plaintiff's application for an order striking out the answer of the defendant, United States of America, and directing that this action should proceed in the usual fashion to a judgment of foreclosure and sale, which said judgment shall provide that the premises shall be sold subject to all real estate taxes, should be granted.

s/ Evar J. Skoog.

(Sworn to by Evar J. Skoog on March 2, 1959.)

IN THE COUNTY COURT OF ERIE COUNTY

COUNTER MOTION OF THE UNITED STATES DESIGNATED "ANSWER TO PLAINTIFF'S PETITION AND MOTION"

The defendant, United States of America, by John O. Henderson, United States Attorney in and for the Western District of New York, for its answer to the petition of the plaintiff sworn to on March 2, 1959, alleges:

I

1. The United States tax lien of $687.07 plus interest against the foreclosed premises is prior in time to the lien or liens against such premises for county tax, city tax, [fol. 98] water rates, sewer rents and assessments (hereinafter collectively referred to as "local tax liens").

2. Under applicable law the United States tax lien is superior to local tax liens. A very brief memorandum is attached citing authorities in support of this statement, (Memorandum omitted from record on appeal.)

3. Plaintiff seeks a judgment of foreclosure and sale which will foreclose and extinguish the United States tax lien, whether or not it is paid in full, and yet preserve the inferior local tax liens.

4. The relief sought by plainfiff

(a) is contrary to law

(b) is inconsistent with the superior status of the United States tax liens as against the local tax liens

(c) creates a controversy between the plaintiff and the United States, which controversy is raised by paragraph 7 of the answer of the United States.

II

5. The plaintiff alleged in paragraph Sixteenth of its complaint that it may be compelled to pay local taxes during the pendency of the action to protect its lien, and it [fol. 99] asked in paragraph Eighteenth of its complaint that any moneys so paid by it be added to the lien of the mortgage and be satisfied out of the proceeds of the foreclosure sale.

6. The plaintiff asked in paragraph Eighteenth of its

complaint that the expenses of the foreclosure sale be paid out of the proceeds of such sale. A demand for such relief in a mortgage foreclosure action means under Civil Practice Act 1087 that the plaintiff wants the local tax liens to be paid by the referee as expenses of the sale.

7. The answer of the United States precisely controverted the aforesaid contentions and requests in the plaintiff's complaint.

8. Now the plaintiff asserts, in the petition of its Vice-President Skoog, that it has not paid any local taxes to protect its lien and does not intend to; and that it desires the premises to be sold *subject to* local tax liens. Consequently the plaintiff now abandons some of the contentions and requests contained in its complaint and now seeks a different type of relief from that requested in its complaint.

9. Therefore, if we assume *arguendo* that the answer of the United States does not raise any controversy as to the relief most recently sought by the plaintiff, the reason for such a situation is that the United States has answered the [fol. 100] complaint, whereas the plaintiff now wants a judgment which it did not ask for in the complaint.

10. However, paragraph 7 of the answer of the United States does in fact controvert the relief now sought by the plaintiff.

Wherefore, the defendant, United States of America, respectfully prays:

1. That this court deny the instant motion of the plaintiff, af.

2. That if the plaintiff obtains a judgment of foreclosure and sale subject to local tax liens, that such sale also be subject to the United States tax lien. On the other hand, if the plaintiff obtains a judgment of foreclosure and sale free and clear of local tax liens, that the United States tax lien be paid behind a sum equal to only the following amounts: (1) The referee's expenses, (2) the legal costs and disbursements of Little and Burt in this proceeding, (3) the principal and interest due upon the plaintiff's mortgage and (4) the amount due on other liens, if any, which became elocate prior to the United States tax lien.

Or in the Alternative

3. That this court require the plaintiff to amend its complaint so as to state therein the relief which it desires and that this court require the United States to prepare [fol. 101] and serve an amended answer within a reasonable time after it is served with the amended complaint; and

4. That thereafter this court proceed to a determination of the issues raised in the amended complaint and amended answer.

Dated: Buffalo, New York, March 12, 1959.

John O. Henderson, United States Attorney in and for the Western District of New York; Attorney for Defendant, United States of America. By: /s/ William I. Schapiro, Assistant United States Attorney.

* * * * * * *

[fols. 101a-104] Additional Papers for the Court of Appeals

[fol. 105] IN THE COUNTY COURT—ERIE COUNTY, STATE OF NEW YORK

BUFFALO SAVINGS BANK, Plaintiff

vs.

BEVERLY VICTORY, Individually and as Administratrix of the Estate of JOSEPH B. VICTORY, also known as JOSEPH VICTORY, deceased; MARILYN M. VICTORY; DUANE B. VICTORY; THE WESTERN SAVINGS BANK OF BUFFALO; UNITED STATES OF AMERICA; B. & L. MOTORS, INC.; DAVID COLE, doing business under the name of DAVE COLE MOTORS, as successor in interest to DAVID COLE and EDWARD COLE, doing business as DAVE COLE MOTORS; THE GRAMATAN NATIONAL BANK AND TRUST COMPANY OF BRONXVILLE; AGNES B. THUMAN, as Executrix of the Last Will and Testament of SYLVESTER C. THUMAN, deceased; MANUFACTURERS AND TRADERS TRUST COMPANY; THE PEOPLE OF THE STATE OF NEW YORK; ALVIN JONES, Defendants.

NOTICE OF APPEAL TO COURT OF APPEALS—Dated June 14, 1961

Sirs:

Take Notice that the plaintiff hereby appeals to the Court of Appeals from the Judgment in the above entitled action entered and filed in the Office of the Clerk of the County of Erie on the 13th day of June, 1961, which judgment was entered upon the Order of the Appellate Division of the Supreme Court, Fourth Department, entered and filed in the Office of the Clerk of that Court on the 18th day [fol. 106] of May, 1961, which judgment modified on the law the resettled judgment of the County Court, Erie County, entered in the Office of the Clerk of the County of Erie on October 20, 1960; and

Take Further Notice that the plaintiff will bring up for review upon the appeal the Order of the Appellate Division of the Supreme Court, Fourth Department, entered in the Office of the Clerk of that Court on the 1st day of July, 1960, reversing the judgment of the County Court, Erie

County, entered in the Office of the Clerk of the County of Erie on the 9th day of June, 1959.

Dated: Buffalo, New York. June 14th, 1961.

Yours, etc., Little and Burt, Attorneys for Plaintiff-Appellant, Office and P. O. Address, Buffalo Savings Bank Bldg., 545 Main Street, Buffalo 3, New York.

To: Clerk of the County of Erie, Neil R. Farmelo, Esq. By C. Donald O'Connor, Assistant U. S. Attorney, Attorney for Defendant-Respondent, United States of America, Office and P. O. Address, 702 U. S. Courthouse, Buffalo 2, [fol: 107] New York. Evan E. James, Esq. Guardian ad Litem for the defendant Marilyn M. Victory, and Designated Attorney for the defendant, Duane B. Victory, Office and P. O. Address, Prudential Building, Buffalo 2, New York. Moot, Sprague, Marcy & Gulick. By William H. Gage, Attorneys for Erie County Savings Bank, Amicus Curiae, Office and P. O. Address, 400 Erie County Bank Building, Buffalo 2, New York.

[fol. 108] In the Supreme Court of New York
Appellate Division—Fourth Department

Buffalo Savings Bank, Respondent

vs.

Beverly Victory, Individually and as Administratrix of the Estate of Joseph Victory, deceased; Marilyn M. Victory; Duane B. Victory; The Western Savings Bank of Buffalo; B. & J. Motors Inc.; David Cole d/b/a Dave Cole Motors, as successor in interest to David Cole and Edward Cole, d/b/a Dave Cole Motors; The Gramatan National Bank and Trust Company of Bronxville; Agnes B. Thuman, as Executrix of the Last Will and Testament of Sylvester C. Thuman, deceased; Manufacturers and Traders Trust Company; The People of the State of New York; Alvin Jones, Defendants, United States of America, Appellant.

Appellate Division's Order of Modification—
Entered May 18, 1961

The above named United States of America one of the defendants in this action, having appealed to the Appellate [fol. 109] Division of the Supreme Court, Fourth Department, from a judgment of the Erie County Court, entered in the office of the Clerk of the County of Erie, on the 20th day of October, 1960, and the said appeal having been argued by Mr. C. Donald O'Connor of counsel for the appellant, and by Mr. John H. Little of counsel for the respondent, plaintiff, and submitted by Messrs. Moot, Sprague, Marcy and Gulick of counsel for Erie County Savings Bank, amicus curiae, and due deliberation having been had thereon.

It is hereby Ordered, That the judgment so appealed from be, and the same hereby, is unanimously modified on the law as follows:

1. The third ordering paragraph, striking out the answer of the defendant United States of Americ is stricken out.

2. The fourth ordering paragraph is modified by striking

therefrom the words "the plaintiff is entitled to have herein" and by substituting therefor the words "there is due on the mortgage," and by striking out the word "besides" and substituting the words "and the plaintiff is entitled to have herein";

3. The sixth ordering paragraph is stricken out and the following is substituted therefor:

"Ordered, Adjudged and Decreed that the mortgaged premises described in the complaint in this action as hereinafter set forth, be sold at public auction in the westerly [fol. 110] vestibule of the Erie County Hall, Buffalo, New York, by or under the direction of Robert W. McNulty of the Town of Orchard Park, in the County of Erie, New York, who is hereby appointed referee for that purpose; that said referee give public notice of the time and place of such sale, according to law and the course and practice of this Court; that the plaintiff or any other party to this action, may become the purchaser or purchasers on such sale; that said referee execute to the purchaser or purchasers on such sale a deed of the premises sold; and that said sale shall be made free and clear of all liens. It is further

"Ordered, Adjudged and Decreed that the purchaser or purchasers at such sale be let into possession on production of the referee's deed or deeds.

"That said referee forthwith, upon receipt of the proceeds of sale or any part thereof, deposit the same in his own name as referee, in the Liberty Bank of Buffalo, and that said referee, after the delivery of said deed, pay from the moneys so deposited the referee's legal fees, the allowance to the Special Guardian and Designated Attorney, and the lawful advertising expenses, and the plaintiff's costs and disbursements as heretofore adjudged, with interest from the date hereof.

"That out of the net proceeds of the sale then remaining, the referee shall set aside the sum found to be due upon the plaintiff's mortgage with interest thereon as aforesaid, [fol. 111] and also a sum sufficient to pay other outstanding liens, if any, which are superior to the tax lien of the United States by reason of their accrual prior to the time of filing of the United States lien, with interest, in a separate bank account in his name to be designated the "Priority

Adjustment Fund. In the event of any uncertainty or dispute as to the amounts or priorities of said liens, the referee shall apply to the County Court for directions, upon notice to all interested parties.

"From the balance remaining, if any, after the setting aside of the said sum, the said referee shall pay the tax lien of the United States, filed on January 15, 1953, with interest, or so much thereof as he is able to pay out of the said balance.

"From the balance remaining, if any, after such payment to the United States, the referee shall pay all local real estate taxes and assessments and water rates which are liens upon the property sold, and pay the cost of redeeming said property from any real estate taxes, assessments and water rates which had not apparently become absolute, the liens of all such taxes, assessments and water rates being inferior to the tax lien of the United States, having accrued subsequent to the time of the filing of the United States tax lien. If there are insufficient moneys available to pay such real estate taxes and assessments and water rates, the balance thereof remaining unpaid shall be paid out of the Priority Adjustment Fund above directed to be set aside.

[fol. 112] "If there be a surplus remaining after making the payments in accordance with the foregoing directions, the referee shall deposit the same, within five days after its ascertainment, with the Liberty Bank of Buffalo, to the credit of this action, but subject to the further order of the Court herein.

"The referee shall pay out of the Priority Adjustment Fund the amount owing to the plaintiff as heretofore adjudged, and thereafter the amount of each of the other liens for which the said sum was so set aside, in order of their priority, or so much thereof as the sum so set aside shall be sufficient to pay.

"That said referee shall made a report of such sale and file it with the Clerk of Erie County; and if the proceeds of such sale, distributed as herein directed, be not sufficient to pay the amount due to the plaintiff, with interest, in full, that said referee specify the amount of such deficiency in his report of sale and that the defendant Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, pay the same to the

plaintiff, and upon application, as required by law, that the plaintiff have judgment and execution therefor, or so much thereof as the Court may determine to be just and equitable.

"That in case the plaintiff becomes the purchaser of said mortgaged premises at said sale, or in the event that the rights of the purchaser at said sale and the terms of sale [fol. 113] under this judgment shall be assigned to or shall be acquired by the plaintiff and a valid assignment thereof be delivered to said referee, said referee shall not require the plaintiff to pay in cash the entire amount bid at said sale, but shall execute and deliver to the plaintiff a deed of the premises sold upon the payment to said referee of the amounts hereinbefore specified as taxed by the Clerk of this Court and adjudged to the plaintiff for costs and disbursements with interest thereon from the date hereof, the referee's fees, advertising expenses and the allowance to the Special Guardian and Designated Attorney, and the amount necessary to pay the aforesaid real estate taxes, assessments and water rates and interest and penalties thereon and the amount necessary to redeem the property sold from any sales for unpaid real estate taxes, assessments or water rates, and the amount which would become payable to the United States upon its tax lien under the directions hereinabove set forth, and the amount, if any, payable to other lienors whose liens were superior to that of the United States under the direction herein above set forth, or in lieu of the payment of said amounts, upon delivery to the referee of receipts showing the payment thereof. If, after allowing the plaintiff credit for the amount due upon its mortgage and interest and credit for the aforesaid payments, there shall remain of the amount so bid a surplus over and above the amounts so credited, the plaintiff shall pay to said referee upon delivery to it or its assigns of said referee's deed the amount of [fol. 114] such surplus and the referee shall deposit such sum in said depository as hereinbefore directed.

"That the said referee take the receipt of the plaintiff or its attorneys and of the other parties or persons to whom payments were made as hereinbefore directed, and file the same with his report of sale; that he deposit the surplus moneys, if any, with the Liberty Bank of Buffalo within five days after the same shall have been received by him

7

to the credit of this action to be withdrawn only on the order of this Court."

As so modified, the judgment appealed from is affirmed without costs.

Per Curiam, Opinion.

Enter.

Alger A. Williams,

Entered 18th day of May, 1961.

Herbert E. Wait, Clerk.

SUPREME COURT, APPELLATE DIVISION,
FOURTH JUDICIAL DEPARTMENT,
CLERK'S OFFICE, ROCHESTER, N. Y.

I, Herbert E. Wait, Clerk of the Appellate Division of the Supreme Court in the Fourth Judicial Department, do hereby certify that the following is a copy of an order made by said court upon the Appeal in the within entitled action or proceeding, and entered in this office on the 18th [fol. 115] day of May, 1961, and of the whole thereof.

In Witness Whereof I have hereunto set my hand and affixed the seal of said court, at the City of Rochester, this 18th day of May, 1961.

Herbert E. Wait, Clerk.

(Seal.)

IN THE SUPREME COURT OF NEW YORK, APPELLATE DIVISION—
FOURTH DEPARTMENT

APPELLATE DIVISION OPINION—May 18, 1961

Argued: February 16, 1961

Appeal from Judgment of Erie County Court, Burke, J., adjudging that the answer of the United States of America be stricken out, that the mortgage f premises be sold free and clear of local taxes, assessments and water rates, same to be paid out of the proceeds of the sale, the liens of the United

States of America having an earlier priority to be paid thereafter if sufficient funds remain.

Judgment entered October 20, 1960.

[fol. 116] APPEARANCES:

Little & Burt (John H. Little, of counsel), Attorneys for Plaintiff-Respondent. Neil R. Farmelo (C. Donald O'Connor, of counsel), Acting United States Attorney, Attorney for Appellant. Evan E. James, Guardian ad Litem, Defendants Victory. Moot, Sprague, Marcy & Gulick, Attorneys for Erie County Savings Bank, Amicus Curiae.

Per Curiam:

This case involves the question of the priority of a United States Government tax lien over liens for subsequently accrued local taxes in a mortgage foreclosure action. In our opinion, the rule of priorities laid down in United States v. City of New Britain, 347 U. S. 81, applies. The detailed terms of our order spell out our view of the proper application of that rule to the facts and relative priorities here present.

County Court, in the order appealed from, has endeavored to invoke what that court has construed to be the doctrine of Rikoon v. Two Boro Dress, Inc., 9 Misc. 2d 591, affd. 8 A. D. 2d 986, rearg. 9 A. D. 2d 783, lv. to app. den. 7 N. Y. 2d 711. The County Court directed the payment of local taxes, subsequent in time to the lien of the United States Government, as "expenses of the sale" under [fol. 117] Section 1087 of the Civil Practice Act, thus giving such local taxes priority over the government lien. It is difficult to determine whether the decision by the Appellate Division in the Rikoon case was based on that theory or whether the decision was affected by the failure of the United States to appeal from prior orders or to move to vacate the judgment of foreclosure. In any event, the provisions of the New York Civil Practice Act permitting the court to direct that local taxes be paid as expenses of the sale, could not prevail as against the authority of the New Britain case (*cf.* Metropolitan Life Ins. Co. v. U. S., 9 A. D. 2d 356, 1st Dept., 1959).

Furthermore, an analysis of the cases decided since New Britain discloses no indication or tendency on the part

of the higher Federal courts to impair or abrogate the New Britain rule. It has been decided that the question of priority of a Federal lien is to be determined by Federal law but that the property to which such a lien attaches is a matter of state law (Aquilino v. U. S., 3 N. Y. 2d 511, revd. 363 U. S. 509, 1960; U. S. v. Durham Lumber Co., 363 U. S. 522, 1960; see also Mtr. of City of New York (Coblentz), 5 N. Y. 2d 300, cert. den. *sub nom.*; U. S. v. Coblenz, 363 U. S. 841, and U. S. v. Bess, 357 U. S. 51). It has also been held that while local "procedure" should be followed in foreclosing a mortgage (U. S. v. Brosnan and Bank of America v. U. S., 363 U. S. 237, 1960), such "procedure" cannot cut off a right expressly granted to the Federal Government by Congress (U. S. v. John Hancock [fol. 118] Mut. Life Ins. Co., 364 U. S. 301, 1960). See also the note in Reports of American Bar Association, 1959, Vol. 84, pp. 661-664.

Inasmuch as County Court failed to follow the determination and intent of our opinion and order, when this case was last before us, we have set forth precisely the provisions to be contained in the modified judgment.

Certain provisions that should be included in the order, which may be of interest are as follows:

> "Ordered, Adjudged and Decreed that the mortgaged premises described in the complaint * * * be sold at public auction * * *; that said referee execute to the purchaser or purchasers on such sale a deed of the premises sold; and that said sale shall be made free and clear of all liens. It is further
>
> "Ordered, Adjudged and Decreed * * *
>
> "That said referee forthwith, upon receipt of the proceeds of sale or any part thereof, deposit the same in his own name as referee, in the Liberty Bank of Buffalo, and that said referee, after the delivery of said deed, pay from the moneys so deposited the referee's legal fees, the allowance to the Special Guardian and Designated Attorney, and the lawful advertising expenses, and the plaintiff's costs and disbursements as heretofore adjudged, with interest from the date hereof.
>
> [fol. 119] "That out of the net proceeds of the sale then remaining, the referee shall set aside the sum found

to be due upon the plaintiff's mortgage with interest thereon as aforesaid, and also a sum sufficient to pay other outstanding liens, if any, which are superior to the tax lien of the United States by reason of their accrual prior to the time of filing of the United States line, with interest, in a separate bank account in his name, to be designated the 'Priority Adjustment Fund.' In the event of any uncertainty or dispute as to the amounts or priorities of said liens, the referee shall apply to the County Court for directions, upon notice to all interested parties.

"From the balance remaining, if, any, after the setting aside of the said sum, the said referee shall pay the tax lien of the United States, filed on January 15, 1953, with interest, or so much thereof as he is able to pay out of the said balance.

"From the balance remaining, if any, after such payment to the United States, the refree shall pay all local real estate taxes and assessments and water rates which are liens upon the property sold, and pay the cost of redeeming said property from any real estate taxes, assessments and water rates which had not apparently become absolute, the liens of all such taxes, assessments and water rates being inferior to [fols. 120-139] the tax lien of the United States, having accrued subsequent to the time of the filing of the United States tax lien. If there are insufficient moneys available to pay such real estate taxes and assessments and water rates, the balance thereof remaining unpaid shall be paid out of the Priority Adjustment Fund above directed to be set aside.

"If there be a surplus remaining after making the payments in accordance with the foregoing directions, the referee shall deposit the same, within five days after its ascertainment, with the Liberty Bank of Buffalo, to the credit of this action, but subject to the further order of the Court herein.

"The referee shall pay out of the Priority Adjustment Fund the amount owing to the plaintiff as heretofore adjudged, and thereafter the amount of each of the other liens for which the said sums was so set aside,

in order of their priority, or so much thereof as the sums so set aside shall be sufficient to pay. * * *"

The judgment appealed from must be modified accordingly.

* * * * * * *

[fol. 140] In the County Court—Erie County, State of New York

Modified Judgment of Erie County Court—June 13, 1961

The above named defendant, United States of America, having appealed to the Appellate Division of the Supreme Court in and for the Fourth Judicial Department, from the judgment of the County Court, Erie County, entered in the Office of the Clerk of the County of Erie on June 9, 1959; [fol. 141] and the said appeal having been duly heard, and the said Appellate Division having thereupon by its order dated June 29, 1960, duly unanimously ordered and adjudged that the said judgment, insofar as appealed from, be reversed on the law and in the exercise of discretion and the case be remitted to this Court for further proceedings in accordance with the opinion of said Appellate Division, without costs to any party; and the said order of reversal having been duly filed in the office of the Clerk of said Appellate Division on July 1, 1960; and a copy of said Order, together with notice of entry thereon, having been duly served on the same day on Messrs. Little and Burt, the attorneys for the said plaintiff, and Neil R. Farmelo, Esq., the attorney for the defendant, United States of America, and the remittitur and record on appeal together with certified copies of said order of reversal having duly been remitted to the Office of the Clerk of the County of Erie, and duly filed on the 8th day of July, 1960; and a resettled judgment dated October 20, 1960, having been made by this Court pursuant to said order of June 29, 1960, and duly entered in the Office of the Clerk of the County of Erie, on October 20, 1960, and the defendant, United States of America, having appealed to the Appellate Division, Fourth Department, from the resettled judgment entered October 20, 1960, in the Office of the Clerk of the County of Erie,

and the said appeal having been heard at a Term of the Appellate Division, Fourth Department, on the 16th day of February, 1961, and the Appellate Division, Fourth De-
[fol. 142] partment, by its Order dated May 9, 1961, and entered in the office of the Clerk of the Appellate Division, Fourth Department, May 18, 1961, having unanimously modified said judgment on the law without costs; and a copy of said Order, together with notice of entry thereof having been duly served on Messrs. Little and Burt, the attorneys for plaintiff, and Neil R. Farmelo, Esq., the attorney for the defendant, United States of America, and the remittitur and record on appeal together with a certified copy of said Order of Modification having been duly remitted to the Clerk of the County of Erie, and duly filed on the 23rd day of May, 1961;

Now, on motion of Little and Burt, attorneys for the plaintiff, it is hereby,

Ordered, that said Order of modification of the Appellate Division, Fourth Department, dated May 9, 1961, be and the same hereby is made the Order of this Court; and it is further

Ordered and Adjudged that the said resettled judgment of this Court dated October 20, 1960, and entered in the Office of the Clerk of the County of Erie on October 20, 1960, be and the same hereby is modified in accordance with the Order of the Appellate Division, Fourth Department, dated May 9, 1961, in manner following:

Ordered, Adjudged and Decreed, that there is due on said mortgage the sum of One Thousand Five Hundred
[fol. 143] Sixty and 13/100 Dollars ($1,560.13), the sum so due as aforesaid, with interest thereon from the 12th day of March, 1959, and the plaintiff is entitled to have herein the sum of Three Hundred Twenty-seven and 90/100 Dollars ($327.90) as taxed by the Clerk of the Court and hereby adjudged to the plaintiff for costs and disbursements in this action, with interest thereon from the date hereof; and it is further

Ordered, Adjudged and Decreed, that Evan E. James, Esq., is awarded the sum of One Hundred Dollars ($100.00) in full of his services as Guardian *ad Litem* and Designated Attorney herein; and it is further

Ordered, Adjudged and Decreed, that the mortgaged

premises described in the complaint in this action as hereinafter set forth, be sold at public auction in the westerly vestibule of the Erie County Hall, Buffalo, New York, by or under the direction of Robert W. McNaulty of the Town of Orchard Park, in the County of Erie, New York, who is hereby appointed referee for that purpose; that said referee give public notice of the time and place of such sale, according to law and the course and practice of this Court; that the plaintiff, or any other party to this action, may become the purchaser or purchasers on such sale; that said referee execute to the purchaser or purchasers on such sale a deed of the premises sold; and that said sale shall be made free and clear of all liens; and it is further

[fol. 144] Ordered, Adjudged and Decreed that the purchaser or purchasers at such sale be let into possession on production of the referee's deed or deeds.

That said referee forthwith, upon receipt of the proceeds of sale or any part thereof, deposit the same in his own name as referee, in the Liberty Bank of Buffalo, and that said referee, after the delivery of said deed, pay from the moneys so deposited the referee's legal fees, the allowance to the Special Guardian and Designated Attorney, and the lawful advertising expenses, and the plaintiff's costs and disbursements as heretofore adjudged, with interest from the date hereof.

That out of the net proceeds of the sale then remaining, the referee shall set aside the sum found to be due upon the plaintiff's mortgage with interest thereon as aforesaid, and also a sum sufficient to pay other outstanding liens, if any, which are superior to the tax lien of the United States by reason of their accrual prior to the time of filing of the United States lien, with interest, in a separate bank account in his name to be designated the "Priority Adjustment Fund". In the event of any uncertainty or dispute as to the amounts or priorities of said liens, the referee shall apply to the County Court for directions, upon notice to all interested parties.

From the balance remaining, if any, after the setting aside of the said sum, the said referee shall pay the tax lien [fol. 145] of the United States, filed on January 15, 1953, with interest, or so much thereof as he is able to pay out of the said balance.

From the balance remaining, if any, after such payment

to the United States, the referee shall pay all local real estate taxes and assessments and water rates which are liens upon the property sold, and pay the cost of redeeming said property from any real estate taxes, assessments and water rates which had not apparently become absolute, the liens of all such taxes, assessments and water rates being inferior to the tax lien of the United States, having accrued subsequent to the time of the filing of the United States tax lien. If there are insufficient moneys available to pay such real estate taxes and assessments and water rates, the balance thereof remaining unpaid shall be paid out of the Priority Adjustment Fund above directed to be set aside.

If there be a surplus remaining after making the payments in accordance with the foregoing directions, the referee shall deposit the same, within five days after its ascertainment, with the Liberty Bank of Buffalo, to the credit of this action, but subject to the further order of the Court herein.

The referee shall pay out of the Priority Adjustment Fund the amount owing to the plaintiff as heretofore adjudged, and thereafter the amount of each of the other liens for which the said sum was so set aside, in order of their priority, or so much thereof as the sum so set aside shall be sufficient to pay.

[fol. 146] That said referee shall make a report of such sale and file it with the Clerk of Erie County; and if the proceeds of such sale, distributed as herein directed, be not sufficient to pay the amount due to the plaintiff, with interest, in full, that said referee specify the amount of such deficiency in his report of sale and that the defendant Beverly Victory, as Administratrix of the Estate of Joseph B. Victory (also known as Joseph Victory), deceased, pay the same to the plaintiff, and upon application, as required by law, that the plaintiff have judgment and execution therefor, or so much thereof as the Court may determine to be best and equitable.

That in case the plaintiff becomes the purchaser of said mortgaged premises at said sale, or in the event that the rights of the purchaser at said sale and the terms of sale under this judgment shall be assigned to or shall be acquired by the plaintiff and a valid assignment thereof be delivered to said referee, said referee shall not require the

plaintiff to pay in cash the entire amount bid at said sale, but shall execute and deliver to the plaintiff a deed of the premises sold upon the payment to said referee of the amounts hereinbefore specified as taxed by the Clerk of the Court and adjudged to the plaintiff for costs and disbursements with interest thereon from the date hereof, the referee's fees, advertising expenses and the allowance to the Special Guardian and Designated Attorney, and the amount necessary to pay the aforesaid real estate taxes, assessments and water rates and interest and penalties [fol. 147] thereon and the amount necessary to redeem the property sold from any sales for unpaid real estate taxes, assessments or water rates, and the amount which would become payable to the United States upon its tax lien under the directions hereinabove set forth, and the amount, if any, payable to other lienors whose liens were superior to that of the United States under the direction hereinabove set forth, or in lieu of the payment of said amounts, upon delivery to the referee of receipts showing the payment thereof. If, after allowing the plaintiff credit for the amount due upon its mortgage and interest and credit for the aforesaid payments, there shall remain of the amount so bid a surplus over and above the amounts so credited, the plaintiff shall pay to said referee upon delivery to it or its assigns of said referee's deed the amount of such surplus and the referee shall deposit such sum in said depository as hereinbefore directed.

That the said referee take the receipt of the plaintiff or its attorneys and of the other parties or persons to whom payments were made as hereinbefore directed, and file the same with his report of sale; that he deposit the surplus moneys, if any, with the Liberty Bank of Buffalo within five days after the same shall have been received by him to the credit of this action to be withdrawn only on the Order of this Court; and it is further

Ordered, Adjudged and Decreed, that each and all of the defendants in this action and all persons claiming under [fol. 148] them or any or either of them, after the filing of the notice of pendency of this action, be and they hereby are forever barred and foreclosed of all right, claim, lien, title, interest and equity of redemption in the said mortgaged premises and each and every part thereof, except as

to the one year period of redemption granted the defendant, United States of America, by Section 2410 of Title 28 of the United States Code Annotated.

The following is a description of the said mortgaged premises hereinbefore mentioned:

All that Tract or Parcel of Land situate in the City of Buffalo, County of Erie and State of New York, bounded and described as follows:

Commencing at a point in the northerly line of Lyth Place, three hundred forty-three and two-tenths (343.2) feet westerly from its intersection with the westerly line of Jefferson Street; running thence westerly along said line of Lyth Place Twenty-four and four-tenths (24.4) feet; thence northerly at right angles one hundred twenty (120) feet to a point midway between the northerly line of Lyth Place and the south line of Northland Avenue, formerly Puffer Street; thence easterly along the line midway between said lines of Lyth Place and Northland Avenue, formerly Puffer Street, twenty-four and four-tenths (24.4) feet; thence southerly at right angles one hundred twenty (120) feet to the northerly line of Lyth Place at the place of beginning.

[fol. 149] Subject to restrictions and rights of utilities of record affecting said premises.

Together With all the right, title and interest of the mortgagor of, in and to the land lying in the bed of any street, road, avenue, lane or right of way as they now exist or formerly existed in, in front of or adjoining the said premises, and in and to all easements, riparian rights and appurtenances and all the estate and rights of the mortgagor in and to said premises.

Together With all fixtures and articles of personal property, now or hereafter attached to, and used in connection with, the above described premises, all of which are covered by said mortgage.

Burke I. Burke, Erie County Judge.

Granted: June 13th, 1961.

O. E. Mueller, Special Deputy Clerk.

[fol. 150] In the Court of Appeals of New York

Buffalo Savings Bank, Appellant,

v.

Beverly Victory, Individually and as Administrator of the Estate of Joseph Victory, Deceased, et al., Defendants, and United States of America, Respondent.

* * * * * * *

Opinion—February 22, 1962

Thomas G. Rickert for Erie County Savings Bank, *amicus curiae*.

Burke, J. The issue here is whether the payment of local real estate taxes and assessments as expenses of sale, rather than the application of that amount toward the payment of a Federal lien filed against the mortgagor prior to the accrual of local taxes, disregards the alleged right of the tax lien of the United States to prior payment.

We find that the Federal tax lien is not entitled to priority over subsequently accrued local tax liens—superior to the mortgage debt—since the respective liens are not comparable charges on real property and the "mortgagee" has an absolute preference over Federal liens.

Plaintiff commenced this action in October, 1958 to foreclose its real property mortgage given by Joseph B. Victory, dated and recorded April 5, 1946. At the time of verification of the complaint there was a balance due on the bond [fol. 151] of $1,473.75, with interest at the rate of 5% per annum from January 10, 1958. The United States was *made a party because of a tax lien it filed in the Erie County Clerk's office January 15, 1953 against the mortgagor, since deceased.* Its answer stated a balance due on the lien of $689.07, plus interest. Plaintiff did not advance any sums for payment of local real property taxes and assessments, which became liens upon the land on and after July 1, 1957.

The mortgagee moved for summary judgment providing that the premises be sold free of the United States tax lien, but *subject* to all real property taxes and assessments. This motion was granted by the Erie County Court. On

appeal by the respondent, the Appellate Division reversed and remitted the case to the County Court, stating that the discretionary authority to have the property sold *subject* to all local real estate taxes "may not properly be exercised in a case such as this in which there is a problem of circular priorities" (11 A D 2d, 160). Thereafter the County Court once more granted summary judgment in favor of the mortgagee providing that the premises be sold and directing that the Referee "shall, as a part of the expenses of the sale, pay out of the proceeds of said sale all real estate taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid real estate taxes, assessments or water rates which have not apparently become absolute." The judgment further foreclosed all rights, liens, and equities of redemption in the premises, except as to the one-year period of redemption granted to the United States by section 2410 of title 28 of the United States Code.

On appeal by the United States, the Appellate Division modified the judgment by providing that "the rule of priorities laid down in *United States* v. *New Britain* (347 U. S. 81) applies" (13 A D 2d 208), and that the local tax liens were not to be paid as expenses of the sale.

The appellant mortgagee contends that the foreclosure procedure of New York is determined by our State law and that a direction to pay local taxes and assessments as expenses of the sale was a proper direction within section 1087 of the New York Civil Practice Act. The United States contends that this court is barred from reaching a determination reversing the Appellate Division and affirming the judgment of Erie County Court. (*United States* v. *New Britain*, 347 U. S. 81.)

Although the United States Supreme Court in recent years has passed on the question of priority of liens and the resulting effect upon mortgagees, their decisions provide no clear command governing us here.

The case of *United States* v. *New Britain* (*supra*) is distinguishable from the present case.

[fol. 152] There the Supreme Court assumed, in the posture of the case as it reached that court, that the contest was between the local government and the Federal Government over their respective rights in surplus funds.

In the usual case, as here, however, the state of facts shows that the dispute is really between the mortgagee and creditors of the mortgagor. The debts of the mortgagor obviously can only be satisfied out of such equity in the real property as the mortgagor may have. When the property is sold in foreclosure, the equity of the mortgagor is extinguished except in the event the bid provides a surplus. Any interest of the mortgagor is fully protected. The mortgagor can bid at the sale, bring surplus money proceedings and resist a deficiency judgment by adducing proof that the value of the property exceeded the bids. In New York State the local government is not paid out of the surplus as the mortgage is subject to its liens, but the Federal Government as a creditor of the mortgagor can look only to the surplus for the satisfaction of its lien. The local government lien is not a levy against the mortgagor, but against the land and must be paid together with other costs from whatever funds the sale of the land produces before (if there were no creditors of the mortgagor) any claimed interest of the mortgagor could be asserted. Our State law has not characterized the nature and extent of the Federal tax lien, but has determined the nature and extent of the property interests of the taxpayer (admittedly a State function), which in the case of real property is conditioned upon the payment of annually recurring governmental land taxes, the payment of which may not be avoided by a foreclosure sale. Of course, the Federal Government's claim, which is based on the claimed interest of the mortgagor, can have no better standing, that is, the Federal lien is also to be paid when there is a surplus in which the mortgagor would have an interest. It would manifestly be unjust to require a mortgagee to pay a creditor of a mortgagor when it appears that the mortgagor had no equity in the real property.

In the *New Britain* suit (*supra*) the court, at the outset, held that the contestants were vying over rights to funds which were considered as surplus. Federal liens securing unpaid withholding and unemployment taxes and insurance contributions owed by the mortgagor attached to his interest in the property subsequent to two mortgages and a judgment lien, but prior to city liens for unpaid real estate and water taxes. Connecticut law provided that the statutory liens for real estate taxes and water rent took prece-

dence over all other liens or incumbrances. Mr. Justice MINTON, speaking for the court, conceding that the mort- [fol. 153] gagee had a preference, stated at pages 85-86: "It does not follow, however, that the City's liens must receive priority as a whole. We believe that priority on these statutory liens is determined by another principle of law, namely, 'the first in time is the first in right.' * * * We think that Congress had this cardinal rule in mind when it enacted § 3670, a schedule of priority not being set forth therein. Thus, the priority of each statutory lien contested here must depend on the time it attached to the property in question and became choate."

Although it may have been the clear intent of Congress that this Federal tax lien have a priority determined by the timeliness with which it attached to the interest of the mortgagor in the real property, *New Britain* does not indicate that it was the intent of Congress to upset established State procedures in foreclosure actions or curtail the absolute preference granted to mortgagees. The statement (p. 88) that "The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors" is far too removed, in the light of the real issue here, from the court's interpretation of congressional intent to have any relation thereto.

Not to be lost sight of in its discussion of the relative priority of the liens is the court's statement that Congress intended to assert the Federal lien "as to any funds *in excess of the amount* necessary to pay the mortgage and judgment creditors." (*United States* v. *New Britain*, 347 U. S. 81, 88, *supra;* italics supplied.) The Supreme Court there recognized that the mortgagor's interest in the proceeds of the foreclosure sale, and consequently the United States lien, reaches only surplus moneys.

But such surplus funds cannot be created by the judgment, for they are the moneys paid for the land in excess of the amount decreed in the judgment. A judgment which omits an item of sale expense in order to create a surplus fund to which subsequent liens can attach violates the statute. Rights of lienors in surplus funds are to be protected, but the law of this State cannot be subverted to create a surplus where none might otherwise exist. Our State law does not prevent such lienors from bidding at a foreclosure

sale in order to protect their liens; but, inasmuch as they are not forced to bid a sum which will create a surplus, it would be inequitable to force the foreclosing mortgagee to bid an inflated price creating a surplus through the scheme of "circular priorities".

In this case the respondent's claim that its lien, founded on the interest of the defaulting mortgagor in the real property, should be granted a priority over the lien on the land, concededly superior to not only the mortgagor's interests in the realty but the mortgagee's interest as well, [fol. 154] depends on the obviously fallacious contention that the lien of the municipality upon the land is akin to the lien of the Federal Government as a creditor of the mortgagor. The plain answer is that the Federal Government is only the creditor of a debtor whose interest in the land is subordinate to the local government lien, which need not be reduced to judgment nor perfected by a filing in the County Clerk's office. As a lien for taxes for essential services supplied for the benefit of the land, it attached directly to the particular parcel of real property. The Federal lien was filed in the Clerk's office against a presumed equity in the real property held by the mortgagor. This respondent imagines a surplus, which is as yet non-existent, against which it would press a lien arising from a debt owed to it by the mortgagor. But in a foreclosure suit the equity of the mortgagor upon which a Federal lien depends should be established according to law, not by an ipse dixit.

The real estate tax and water-rent liens are not liens which attach to the property merely because of an unconnected indebtedness of the owner of the land, as are Federal tax liens. The property itself, in its very nature as land, incurs the indebtedness. It matters not who owns the land for, even if the United States in foreclosing its lien had a Receiver appointed to sell the land, the property could not have been transferred free and clear of the local tax liens attaching while the United States was in possession (see *Borock* v. *City of New York*, 268 F. 2d 412).

Thus, the circumstances in the present case are quite different from those assumed in *United States* v. *New Britain* (*supra*). The question is not "the relative priority of statutory federal and municipal liens to the proceeds of

a mortgage foreclosure sale of the property to which the liens attached" (*United States* v. *New Britain, supra*, p. 82), but whether the payment of the Federal lien filed against the mortgagor should be mandated where there is no evidence that the mortgagor has a financial interest at the time of foreclosure. Here we are faced with the true parties in interest—the mortgagee and the Federal Government. Under New York law no funds are deemed surplus until the expenses of the sale, the costs of the action and the amount of the foreclosed mortgage debt plus interest have been fully paid. (Civ. Prac. Act, § 1082). The [fol. 155] procedure[1] in this State requires the officer conducting the foreclosure sale to pay out of the proceeds all taxes, assessments and water rates which are liens on the property, unless the judgment directs otherwise. These payments are expenses of the sale by statute. Therefore, the question of what, if any, financial interest the mortgagor-taxpayer had on which the Federal Government had a lien can only be determined under the State law after the foreclosure sale.

The procedure adopted by the Appellate Division does not follow New York State procedure. Up to the present time the expenses of sale have always been determined by State, rather than Federal, law, and even the judgment in *New Britain* (*Brown* v. *General Laundry Serv.*, 19 Conn. Supp. 335) recognized that the expenses of sale have prior-

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[1] (Civ. Prac. Act, § 1087)—"Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold and redeem the property sold from any sales for unpaid taxes, assessments or water rates, which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. The provisions of this section shall not apply to any judgment in an action wherein any municipal corporation of this state is the plaintiff and the purchaser at the foreclosure sale thereunder."

ity over any other claim to the moneys realized on the sale. Certainly precedent demands that we should reaffirm the principle that State procedures govern.

Moreover, the Supreme Court in a recent decision has allowed State law to control the procedure of foreclosure and payment of liens. In *United States v. Brosnan* (264 F. 2d 762, affd. 363 U. S. 237) Federal tax liens attached to property subject to a purchase-money mortgage, but prior to local tax liens.[2] Upon default in payment of the mortgage, the mortgagee caused a confession of judgment to be entered on the bond. A writ of *fieri facias* for the sale of the property issued to the Sheriff. The United States was not a party to this action. "The sheriff held the sale of the property on January 3, 1956; it was bid in by Brosnan and Jacob [assignees of the mortgagee] for $6,203 and, it is presumed, the discharge of the mortgage indebtedness. *The amount of the bid went to satisfy* costs of the sale, and for various outstanding local taxes." (264 F 2d 764; emphasis supplied.)

More than a year later the United States brought an action to enforce its lien, but the District Court (164 F. Supp. 357) and the Court of Appeals for the 3d Circuit (264 F. 2d 762, *supra*) held that the junior lien of the Government was extinguished even though the United States had not been joined as a party. The Supreme Court affirmed the determinations below (363 U. S. 237). The opinion was replete with references to State law and procedure—something not found in *New Britain*.

The Supreme Court's attention was drawn to the fact that Pennsylvania gave its own tax liens more favorable treatment than it rendered the Federal liens at pages 25-27 [fol. 156] of the United States' brief: "Indeed, Pennsylvania law itself treats state tax liens more favorably than federal tax liens. A Pennsylvania statute provides that 'The lien of all taxes * * * against any real estate within this

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[2] The Federal liens, amounting to $40,403.34 attached to the property between April 11, 1949 and November 28, 1951 (Exhibit B to complaint of United States). The local taxes paid out of the proceeds of the sale were county, township and school taxes for the period 1952-1955 in the amount of $5,756.90 (Transcript of Record, p. 22).

Commonwealth shall be divested by any judicial sale of such land: Provided, The amount of the purchase money shall equal the amount of the said taxes.' (Purdon's Penna Statutes Annotated, Title 53, Section 7104, Appendix, *infra*, p. 36). While Pennsylvania law permits discharge of a junior lien on realty through foreclosure of a prior mortgage at a sheriff's sale, the Commonwealth's liens may be divested only to the extent permitted by statute [cases cited]. Thus, under Pennsylvania law the state's tax lien will be discharged through foreclosure only if the state's tax claim is paid in full out of the proceedings. The decision below holds, however, that the same foreclosure proceeding wipes out the federal lien even though the United States receives not a single penny toward payment of its claim."

The dissent makes it clear that the objection to Pennsylvania procedure in extinguishing the lien of the Federal Government was not that it was done according to State procedure, but that Pennsylvania procedure did not provide for notice to junior lienors (363 U. S. 261).

Although the main facet of the *Brosnan* case was a sanction of Pennsylvania's procedure, whereby the United States was not required to be a party to the action in order to extinguish its lien, the affirmance also necessarily sanctioned that State's procedure of paying local taxes out of the proceeds of the sale without the necessity of creating a surplus with which to pay liens prior to the local tax liens. (Purdon's Pennsylvania Statutes Ann., tit. 53, §§ 7103-7105.) This is a departure from the holding in the *New Britain* case, as that case is construed by the respondents. The Supreme Court in *Brosnan* also gave effect to the preference accorded to mortgagees by State and Federal law, and the decision tends toward the principle stated in the dissenting opinion of Haynsworth, J., in *United States* v. *Bond* (279 F. 2d 837, 848, cert. den. 364 U. S. 895).

According to respondent's reasoning, the mortgagee, concededly not under any obligation to pay the Federal lien on the interest of the mortgagor at the time the lien was filed, becomes obligated when it bids in at the foreclosure sale simply because the mortgagee as bidder under State law must bear the cost of unpaid local taxes on the land falling due subsequent to the filing of the Federal lien. This imposition of liability is justified on the assumption that at

the time of foreclosure the undetermined financial interest of the mortgagor has a value at least equal to the amount of the unpaid taxes which fell due subsequent to the filing of the Federal lien.

The circumstances present in the case of the foreclosure of a real estate tax lien by a municipality illustrate best the [fol. 157] paradoxical result of the application of the rule respondent asserts. Under that rule the municipality which is foreclosing the tax lien for local taxes, which accrued subsequent to the filing of a tax lien filed against the equity of the property owner, shall be obligated to discharge the Federal tax lien in order to secure a clear title. But the interest of such a property owner obviously is worthless, since neither the property owner nor the public would bid on the tax lien which the municipality ultimately had to foreclose. In spite of this evidence of lack of value, the respondent would contend that the Federal lien has a priority because the nonexistent financial interest of the property owner cannot be diminished by giving priority to local taxes accrued subsequent to the filing of the Federal lien and that, therefore, the municipality must satisfy the Federal lien. In other words, the financial interest of the property owner which was nil develops value through the default of the property owner on local taxes. This *nonsequitur* had to be resorted to because respondent realizes its lien is not a lien on the land, but is only a lien on the equity of the owner. Therefore it had to invent an equity which the owner could be said to possess at the time of the foreclosure in order to avoid the controlling State law which provides that the nature and extent of the property interests of a defaulting mortgagor can only be determined after a foreclosure sale conducted according to the State laws. The patent infirmity of this contrivance explains why the respondent has improperly invoked a canon, in a matter involving disparate liens, which is relevant only to the relationships of kindred liens, i.e., "the first in time is the first in right."

Such a rule, if accepted now, would adversely affect the credit rating of all municipal bonds which are marketed on the assumption that local taxes are a first lien on the land within the municipality. It would also impair the borrowing power of municipalities because it makes the munici-

pality liable for the personal debts a tax delinquent property owner owes to the Federal Government. Finally, it would cloud the title of properties which the municipalities have resold after acquisition through tax lien foreclosures.

The logic of the respondent appears to be as circular as the type of priority that it would have this court stamp with approval. The procedure that it proposes is novel to this State. Were local taxes not owing upon the land, the United States could not, through its own admissions, compel the creation of a surplus in which its lien would share with the judgment creditors. Is it logical that the Federal Government should be entitled to compel the mortgagee to treat the amount of real estate taxes subsequently accruing as a surplus to be applied toward payment of the Federal lien? [fol. 158] To accede to this attempt to foist the personal debts of the mortgagor owing to the United States on the mortagee is to agree to the imposition of an indirect tax on savings banks who have invested billions of dollars in mortgages and on the savings of our citizens invested in mortgages which have been accorded a preference even under Federal law (U.S. Code, tit. 26, § 6323, subd. [a]). If the preference is to be whittled down, it should be done explicitly by a statute enacted by the representatives of the States in the national Congress and not by the courts.

The direction in the resettled judgment of foreclosure that the Referee should pay the real estate taxes, assessments and water rates out of the proceeds of the sale as expenses of the sale is not only in conformity with State law (Civ. Prac. Act, § 1087), but is also in keeping with the preference conferred on the mortgagee by State and Federal law protecting "all those rights which the Congress must have known the mortgagee commonly and usually possesses" (*United States v. Bond*, 279 F. 2d 837, 851, *supra*). Being the proper procedure of this State, the resettled judgment of foreclosure of October 20, 1960 should be affirmed.

The judgment of the Appellate Division, entered June 13, 1961, should be reversed and the judgment of the County Court, Erie County, entered October 20, 1960, reinstated, without costs.

FULD, J. (dissenting). By its present decision, the court is holding that a Federal tax lien filed against a mortgagor

prior to the accrual of local real estate taxes and assessments—which are superior to the mortgage debt—is not entitled to priority over those subsequently accrued local liens." I cannot agree. In my view, the conclusion reached by the majority is opposed by controlling authority. (*See United States v. New Britain*, 347 U. S. 81; see, also, *United States v. Bond*, 279 F. 2d 837 [4th Cir.]; *United States v. Christensen*, 269 F. 2d 624 [9th Cir.]; *Stadelman v. Hornell Woodworking Corp.*, 172 F. Supp. 156 [U. S. Dist. Ct., W. D. N. Y.]; *United States v. Laird*, 155 F. Supp. 105 [U. S. Dist. Ct., N. H.]; *Union Central Life Ins. Co. v. Peters*, 361 Mich. 283.) Nor may the impact of such authority be avoided by having the State, through legislative enactment or court decision, label local taxes and assessments "expenses of the sale," that is, of the mortgage foreclosure sale following the action brought by the mortgagee (Civ. Prac. Act, § 1087).

Once it has been determined, under State law, that the taxpayer has property or rights to property, "state law is inoperative to prevent the attachment of liens created by [fol. 159] federal statutes in favor of the United States." (*United States v. Bess*, 357 U. S. 51, 57.) Moreover, when a Federal tax lien has attached to property of the taxpayer, as undoubtedly it has here, State law may not destroy it. (*See Commissioner v. Stern*, 357 U. S. 39.) As already indicated, calling the local taxes "expenses of the sale" does not help the local taxing authority, for it is to substance, not form, that the courts look. Local taxes do not result from the mortgage foreclosure sale; on the contrary, they are pre-existent to the sale. Accordingly, the State's characterization of them as "expenses of the sale"—appropriate though it may be for the State's own purposes—is thoroughly unreal in our present context and completely ineffectual to affect the priority of the Federal lien. (Cf. *United States v. Gilbert Associates*, 345 U. S. 361.)

In deciding questions concerning the relevant priorities of a Federal tax lien and other liens, it is perfectly clear that State law determines the nature and extent of the property interests of the taxpayer and the Federal law determines the priority of the competing claims themselves. (See, e.g., *Aquilino v. United States*, 363 U. S. 509, 515-516; *United States v. Brosnan*, 363 U. S. 237, 240; *United States*

v. *Bess*, 357 U. S. 51, 55, *supra*; *United States* v. *Acri*, 348 U. S. 211, 213.) Although the court's opinion herein does not expressly reject this proposition—as to the proper role of State and Federal law in this area—its decision stands squarely opposed to it. What the court has done, under State law, is to characterize the nature and extent of the Federal lien and determine its priority in competition with local liens—a function exclusively reserved to the Federal law. (See *Aquilino* v. *United States*, 363 U. S. 509, *supra*.) Thus, the majority describes the Government's status in the present action as that merely of "a creditor of the mortgagor" and concludes that, since the Government's position "is based on the claimed interest of the mortgagor, [it] can have no better standing [than the mortgagor], that is, the Federal lien is also to be paid when there is a surplus [over mortgage debt plus local taxes] in which the mortgagor would have an interest" (opinion, p. 37). To employ the language of the opinion in the *Brosnan* case, this is not an authorized State determination of the "'property and rights to property' * * * to which a government tax lien attaches," but rather an unauthorized State determination of "matters directly affecting the nature or operation of [federal tax] liens" (363 U. S. 237, 240).

Furthermore, giving priority to the after-accrued local taxes, as the majority is here doing, is directly contrary to the Supreme Court's decision in *United States* v. *New Britain* (347 U. S. 81, *supra*). In that case, in addition to prior mortgages and a prior judgment lien, the taxpayer's [fol. 160] property was incumbered by a Federal tax lien and, subsequent in time to such lien, by a municipal tax lien. The Connecticut Supreme Court reasoned, as the majority does here, that, since Federal law subordinated the Federal tax lien to mortgage and judgment liens and since, under State law, these mortgage liens were subordinated to real property tax liens, the Federal tax lien had to be subordinated to the local real property tax lien. (See *Brown* v. *General Laundry Serv.*, 139 Conn. 363, 373.) In answer to this argument, the Supreme Court of the United States declared (347 U. S., at p. 88):

> "We do not agree. The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors.

> That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien."

Even more recently, in *United States* v. *Brosnan* (363 U. S. 237, *supra*), the Supreme Court, citing numerous decisions, "rejected" the very position taken by the majority in this case (363 U. S., at p. 241):

> "This Court has repeatedly rejected the contention that because a fee owned by a taxpayer was already encumbered by a lien which enjoyed seniority under state law, the Government's lien necessarily attached subject to that lien."

The rule adopted in the *New Britain* case as the Federal rule for resolving conflicts between a Federal tax lien and local real property tax liens is the olden one that "'the first in time is the first in right'" (347 U. S., at p. 85). As there pointed out, "When the debtor is insolvent, Congress has expressly given priority to the payment of indebtedness owing the United States, whether secured by liens or otherwise, by § 3466 of the Revised Statutes, 31 U. S. C. (1946 ed.) § 191. In that circumstance, where all the property of the debtor is involved, Congress has protected the federal revenues by imposing an absolute priority." Where, however, the court continued (p. 85), "the debtor is not insolvent, Congress has failed to expressly provide for federal priority, with certain exceptions not relevant here." (And see Internal Revenue Code of 1939, U. S. Code, tit. 26, § 3672; Internal Revenue Code of 1954, U. S. Code, tit. 26, § 6323).[1] And, added the court, "There is nothing in the language of § 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the [fol. 161] specific categories of interests set out therein" (p. 88), that is, mortgagees, judgment creditors, pledgees and purchasers. Accordingly, the relative priority of each

[1] It is appropriate to note at this point that the record before us, like the record in *New Britain* (347 U. S., at p. 85), does not indicate that the mortgagor taxpayer was insolvent.

lien here involved "must depend upon the time [each of them] attached to the property in question and became choate" (p. 86. See, also, *United States* v. *Bond*, 279 F. 2d 837, *supra*; *United States* v. *Christensen*, 269 F. 2d 624, *supra*).

The court seeks to distinguish *New Britain* from the present case on the ground that the contest there "was between the local government and the Federal government over their respective rights in surplus funds," whereas here the "facts [show] that the dispute is really between the mortgagee and creditors of the mortgagor" (opinion, p. 36). Starting from this premise, the majority urges that, if the contest were between the Federal Government and the local taxing authorities, *New Britain* would control and the Government would prevail. But, since the dispute here is between the United States, as a creditor of the Mortgagor, and the mortgagee, the latter must prevail, because (the argument proceeds) the Government can have no better standing than the mortgagor himself. And the court seeks to bolster this conclusion by claiming that "the respective liens [in this case] are not comparable charges on real property" (p. 35). In my judgment, the proffered ground for distinction is not tenable.

It is true that in *New Britain* the contest was between the city and the Federal Government but, as the facts disclosed and later developments made clear (see *Brown* v. *General Laundry Serv.*, 19 Conn. Supp. 335), the real parties in interest were the Federal Government and private lienors of the debtor's real estate who were entitled to priority over the Federal lien by the express terms of the Federal lien statutes. The State of Connecticut received its taxes in full at the expense of lienors whose liens were prior to those of the Federal Government. The fact that the contest in *New Britain* was between the city and the Federal Government and in this case between the mortgagee and the Government neither compels nor justifies a difference in result.

As I have already noted, it is the majority's assertion that the lien for local taxes must take precedence over the Government's lien because the respective liens are not comparable charges on real property. This is its position (pp. 36-38): On the one hand, "The local government lien is not a levy against the mortgagor, but against the land."

On the other hand, the Federal Government's status is only that of "a creditor of the mortgagor," its claim merely one "based on the claimed interest of the mortgagor." And its lien, rather than being a lien which "attach[es] directly to the particular parcel of real property" as does that of the [fol. 162] local government, "attach[es] to the property merely because of an unconnected indebtedness of the owner of the land." In other words, the Federal lien is not against the land, but "against a presumed equity in the real property held by the mortgagor."

Having made these distinctions, the court goes on to suggest that the difference in the way these liens arise assures priority to the liens of the local taxing authorities over the lien of the Federal Government. From this and the status ascribed to the Federal lien, it is the court's conclusion that "the Federal government's claim, which is based on the claimed interest of the mortgagor, can have no better standing [than the mortgagor's claim], that is, the Federal lien is also to be paid when there is a surplus [above the mortage debt and expenses of sale, including local taxes] in which the mortgagor would have an interest" (opinion, p. 37).

The fallacy of this argument, I venture, is that it mistakes the Federal law with respect to the status and incidence of the Federal interest. The Federal Government is no mere unsecured creditor of a delinquent taxpayer. It is, rather, the holder of "a lien * * * upon all property or rights to property, whether real or personal, belonging to such person" (Internal Revenue Code of 1954, U. S. Code, tit. 26, § 6321). Such a lien attaches to the real property owned by the taxpayer at the time the "[tax] assessment is made" (U. S. Code, tit. 26, § 6322), not to whatever equity he may have in it after a subsequent mortgage sale. In short, the Federal lien is not, as the majority insists, "against a presumed equity in the real property held by the mortgagor," but against the land itself. The rights of the Federal Government to the proceeds of the mortgage sale are not, therefore, limited to those of the mortgagor.

Let me state the matter somewhat differently. The lien of the United States arose when the assessments were made, and it attached to the mortgaged property at that time. Consequently, if the sale of the property had then been

held, that lien could have been satisfied out of the proceeds of such sale after payment of proper expenses and of the amount then due on the mortgage plus interest to the date of payment. The local taxes here involved had not yet come into being and might never have become liens against the property. They might have been paid by the mortgagor or the property *might have been foreclosed before* they became due. Since, therefore, the liens of the local authorities had at best only a potential existence, we do not reach the question whether those liens were choate when the Federal liens attached. It comports neither with reality nor with law to give such "potential liens" priority over the pre-existing matured Federal lien by labeling them "expenses of the sale" in foreclosure proceedings.

[fol. 163] Indeed, an argument very similar to that made by the court here, namely, that the respective charges of the Federal Government and the local taxing authorities are "not comparable charges on real property"; was expressly made and rejected in the *New Britain* case (347 U. S. 81, *supra*). It had evidently been argued that the local tax liens should take precedence over the Federal tax lien because they were "specific" while the Federal lien was "general". With respect to this contention, the Supreme Court declared (p. 84):

> "[T]he fact that one group of liens [the local] is specific and the other [the federal] general in and of itself is of no significance in these cases . . . . Thus, the general statutory liens of the United States are as binding as the specific statutory liens of the City. The City gains no priority by the fact that its liens are specific while the United States' liens are general."

Finally, a word must be said about the majority's characterization of the decision in *United States* v. *Brosnan* (363 U. S. 237, *supra*) as "a departure" from the holding in the *New Britain* case. In the first place, *Brosnan* was concerned with a question whether a Federal tax lien could be extinguished under a State procedure for foreclosure in which the Federal Government, *a junior lienor*, was not, and need not have been, a party; what was involved, therefore, was not the problem of priority at issue here. In the second place, although local taxes had been paid out

of the proceeds of the mortgage sale and thus had, in effect, achieved priority, that issue was never raised on appeal, the sole issue being—to cull from the court's opinion—"whether the federal lien was effectively extinguished by state proceedings to which the United States was not, nor was required under state law to be a party" (363 U. S., at pp. 238-239). The third and (to me) conclusive reason why *Brosnan* may not be taken to be a departure from the *New Britain* holding is that in *Brosnan* the Supreme Court actually cited *New Britain* with approval (363 U. S., at p. 241, n. 4) and restated one of the principles which it had announced; thus, it wrote in *Brosnan* (p. 241): "This Court has repeatedly rejected the contention that because a fee owned by a taxpayer was already encumbered by a lien which enjoys seniority under state law, the Government's lien necessarily attached subject to that lien". As is evident, far from supporting the majority view in the present case, the opinion in *Brosnan* stands with *New Britain* to refute it.

In the sum, then, in situations of this kind, the lien of the Federal Government must be recognized as prior in right to that of the local taxing authorities. This follows from the fact that it is prior in time. But this does not mean that those local taxing authorities will not collect their [fol. 164] taxes. The majority opinion has placed the contest in its proper setting. The dispute is between the mortgagee and the Federal Government as a creditor of the mortgagor. The local taxing authorities will be paid at the expense of the mortgagee so there will be no adverse economic impact upon the taxing authorities. The mortgagee's interest in the proceeds of the mortgage sale may, perhaps, be diminished. But the mortgagee is not left without recourse where the mortgagor is liable for payment of the debt secured by the mortgage and he is not insolvent. In such a case, the mortgagee may collect the "residue" or balance due from the mortgagor by way of a deficiency judgment (Civ. Prac. Act, §§ 1082, 1083).

I would affirm the judgment of the Appellate Division.

Chief Judge Desmond and Judges Dye, Froessel and Van Voorhis concur with Judge Burke; Judge Fuld dissents in an opinion in which Judge Foster concurs.

Judgment of Appellate Division, entered June 13, 1961, reversed and judgment of the County Court, Erie County, entered October 20, 1960, reinstated, without costs.

[fol. 165] COURT OF APPEALS

STATE OF NEW YORK, ss:

Pleas in the Court of Appeals, held at Court of Appeals Hall, in the City of Albany, on the 22nd day of February in the year of our Lord one thousand nine hundred and sixty-two, before the Judges of said Court.

Witness, The Hon. Charles S. Desmond, Chief Judge, Presiding. Raymond J. Cannon, Clerk.

REMITTITUR — February 22, 1962

[fol. 166]

BUFFALO SAVINGS BANK, Appellant,

vs.

BEVERLY VICTORY, INDIVIDUALLY &c., & ors., &c., Defendants,

UNITED STATES OF AMERICA, Respondent.

Be it Remembered, That on the 27th day of September in the year of our Lord one thousand nine hundred and sixty-one, Buffalo Savings Bank, the appellant in this cause, came here unto the Court of Appeals, by Little & Burt, its attorneys; and filed in the said Court a Notice of Appeal and return thereto from the judgment of the Appellate Division of the Supreme Court in and for the Fourth Judicial Department. And United States of America, the respondent in said cause, afterwards appeared in said Court of Appeals by Neil R. Farnedo, its attorney.

Which said Notice of Appeal and the return thereto, filed as aforesaid, are hereunto annexed.

[fol. 167] Whereupon, The said Court of Appeals having heard this cause argued by Mr. John H. Little, of counsel for the appellant, and by Mr. C. Donald O'Connor, of

counsel for the respondent, briefs filed by amici curiae, and after due deliberation had thereon, did order and adjudge that the judgment of the Appellate Division of the Supreme Court appealed from herein, entered June 13, 1961, be and the same hereby is reversed and the judgment of the County Court, Erie County, entered October 20, 1960, reinstated, without costs.

And it was also further ordered, that the record aforesaid, and the proceedings in this Court, be remitted to the County Court, Erie County, there to be proceeded upon according to law.

[fol. 168] Therefore, it is considered that the said judgment be reversed &c. as aforesaid.

And hereupon, as well the Notice of Appeal and return thereto aforesaid as the judgment of the Court of Appeals aforesaid, by it given in the premises, are by the said Court of Appeals remitted into the County Court, Erie County, before the Judges thereof, according to the form of the statute in such case made and provided, to be enforced according to law, and which record now remains in the said County Court, before the Judges thereof, &c.

Raymond J. Cannon, Clerk of the Court of Appeals of the State of New York.

Court of Appeals, Clerk's Office.
Albany, February 22, 1962.

I Hereby Certify, that the preceding record contains a correct transcript of the proceedings in said cause in the Court of Appeals, with the papers originally filed therein, attached thereto.

Raymond J. Cannon, Clerk.

[fol. 169] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1961

No. 922

UNITED STATES, Petitioner,

vs.

BUFFALO SAVINGS BANK

ORDER ALLOWING CERTIORARI—June 11, 1962

The petition herein for a writ of certiorari to the Court of Appeals of the State of New York is granted and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Frankfurter took no part in the consideration or decision of this application.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes involved	2
Statement	2
Reasons for granting the writ	5
Conclusion	13
Appendix A	14
Appendix B	39

CITATIONS

Cases:

First Nat. Bank of Chippewa Falls v. *Henneman Co.*, 10 Wis. 2d 260, 103 N.W. 2d 24, certiorari denied, 364 U.S. 836 — 11

Southern Ohio Savings Bank & Trust Co. v. *Bolce*, 165 Ohio St. 201, 125 N.E. 2d 217 — 11

Stadelman v. *Hornell Woodworking Corp.*, 172 F. Supp. 156 — 11

Union Central Life Ins. Co. v. *Peters*, 361 Mich. 283, 105 N.W. 2d 196, reversed *sub nom. United States* v. *Union Central Life Ins. Co.*, 368 U.S. 291 — 11

United States v. *Bond*, 279 F. 2d 837, certiorari denied, 364 U.S. 895 — 11

United States v. *Bosman*, 363 U.S. 237 — 10

United States v. *Christenson*, 269 F. 2d 624 — 11

United States v. *New Britain*, 347 U.S. 81 — 2, 5, 6, 7, 8, 9, 11

United States v. *Wasserman*, 297 F. 2d 491 — 11

63-754 62 2-1

Statutes:

Internal Revenue Code of 1939:

	Page
Sec. 3670 (26 U.S.C. 1952 ed., Sec. 3670)	2, 5, 6, 8, 10, 39
Sec. 3671 (26 U.S.C. 1952 ed., Sec. 3671)	2, 6, 8, 39
Sec. 3672(a) (26 U.S.C. 1952 ed., Sec. 3672(a))	2, 6, 39
Internal Revenue Code of 1954:	
Sec. 6323 (26 U.S.C. 1958 ed., Sec. 6323)	6
New York Civil Practice Act:	
Sec. 1082	2, 40
Sec. 1087	2, 3, 12, 40

In the Supreme Court of the United States

OCTOBER TERM, 1961

No. —

UNITED STATES OF AMERICA, PETITIONER

v.

BUFFALO SAVINGS BANK

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Court of Appeals of the State of New York.

OPINIONS BELOW

The opinion of the Erie County Court entered May 29, 1959 (R. 68–75) is reported at 186 N.Y.S. 2d 960, 17 Misc. 2d 564. The opinion of the Appellate Division entered July 1, 1960 (R. 40–44) is reported at 202 N.Y.S. 2d 70, 11 A.D. 2d 158. The opinion of the Erie County Court on remand, entered on October 18, 1960 (R. 29–39), is reported at 206 N.Y.S. 2d 518, 26 Misc. 2d 443. The opinion of the Appellate Division entered May 18, 1961 (R. 115–120), on the second appeal, is reported at 215 N.Y.S. 2d 189, 13 A.D. 2d 207. The opinion of the New York Court of

Appeals entered February 22, 1962 (Appendix A, *infra*, pp. 14–36), is not officially reported.

JURISDICTION

The judgment of the Court of Appeals of the State of New York was entered on February 22, 1962 (Appendix A, *infra*, pp. 37–39). The jurisdiction of the Court is invoked under 28 U.S.C. 1257(3).

QUESTION PRESENTED

Whether the priority of payment accorded an earlier-arising Federal tax lien by *United States* v. *New Britain*, 347 U.S. 81, may be defeated by a provision of State law that payments to discharge local tax liens shall be "deemed" expenses of a mortgage foreclosure sale.

STATUTES INVOLVED

The following statutory provisions are set forth in Appendix B, *infra*, pp. 40–41: Sections 3670, 3671 and 3672(a)(1) of the Internal Revenue Code of 1939, and Sections 1082 and 1087 of the New York Civil Practice Act.

STATEMENT

In 1946 the Buffalo Savings Bank lent money to Joseph B. Victory, receiving a mortgage on real property to secure its loan. In 1953 the United States filed in the Erie County Clerk's Office notice of a federal tax lien against Victory's property for $857.07. (R. 58–59, 66, 87–88). On and after July 1, 1957, local liens attached to the mortgaged property resulting from defaults in the payment of real estate taxes for 1957 and 1958 owed to the City of Buffalo, real estate taxes for 1958 owed to Erie County, and

sewer rents for 1958 levied by the Buffalo Sewer Authority.[1] (R. 63–64, 82–83). The present action for foreclosure of its mortgage was begun in the Erie County Court on October 21, 1958, by the Buffalo Savings Bank. Besides the mortgage, there were sums due on the lien-secured debts owing to the United States, Erie County, the City of Buffalo, and the Buffalo Sewer Authority. (R. 76–86; App. A, p. 15.)

On June 9, 1959, the county court entered a judgment providing that the mortgaged property should be sold "subject to all local real estate taxes, assessments and water rates" (R. 50), but free and clear of the federal tax liens, and that the proceeds should be used first to satisfy the mortgage debt. Upon appeal by the United States, the Appellate Division on July 1, 1960, reversed the judgment, stating that the sale free of the federal lien but subject to local liens would erroneously give the local liens "a superpriority" although on the basis of the federal rule of "first in time, first in right" the local liens were subordinate to the earlier-arising federal lien (R. 42, 45–46). It directed a sale of the property free and clear of all liens.

Upon remand, the county court, on October 20, 1960, amended its judgment to order a sale free of all liens, the proceeds of which were to be used first to pay all local real estate taxes, assessments, and water rates "as a part of the expenses of the sale," pursuant to Section 1087 of the New York Civil Practice Act (R. 9). On appeal by the United States the Appel-

[1] The mortgagee bank did not advance any sums for payment of these local real property taxes and assessments.

late Division on May 18, 1961, ordered modification of the judgment to apply to the proceeds of such a foreclosure sale "the rule of priorities laid down in United States v. City of New Britain, 347 U.S. 81," (R. 116) under which the local tax and water liens were "inferior to the tax lien of the United States, having accrued subsequent to the time of the filing of the United States tax lien." (R. 111.)[2] This modification was made in the judgment of the Erie County Court entered June 13, 1961. (R. 140–149.)

The mortgagee bank appealed to the New York Court of Appeals from the judgment of the Appellate Division entered May 18, 1961. (R. 105–106.) That court (Judges Fuld and Foster dissenting), although approving of the order directing a sale of the property free and clear of all liens, reversed the Appellate Division's decision as to the distribution of the proceeds and reinstated the County Court judgment of foreclosure of October 20, 1960, authorizing the payment of later-arising local taxes ahead of prior

[2] The Appellate Division directed that the property be sold free and clear of all liens; that the proceeds be deposited in a bank; that from such proceeds the referee pay the fees, costs and disbursements allowed; that out of the net proceeds then remaining, the referee set aside, in a separate bank account in his name, designated as "Priority Adjustment Fund", the sum due upon the mortgage and also a sum sufficient to pay other outstanding liens, if any, superior to the tax lien of the United States; that from the balance, if any, remaining, the referee pay first the tax lien of the United States, and then the local real estate taxes, assessments and water rates; that if there were insufficient moneys available to pay such real estate taxes, assessments and water rates, the balance thereof was to be paid out of the Priority Adjustment Fund. (R. 108–114.)

federal taxes, as expenses of the foreclosure sale. (Appendix A, *infra*, pp. 27, 36.)

REASONS FOR GRANTING THE WRIT

I

The decision of the New York Court of Appeals is squarely in conflict with this Court's decision in *United States* v. *New Britain*, 347 U.S. 81.

The relevant facts of the *New Britain* case were these. A foreclosure sale of the taxpayer's real property produced a fund of $28,071 against which were claims of $31,000 including sale expenses, two mortgages, a recorded judgment, city real-estate-tax liens and water-rent liens, and federal tax liens. The state courts held that the city liens were entitled to payment prior to all other claims except those for expenses of sale, regardless of the date at which they became perfected and attached to the taxpayer's property. This Court held, in an opinion which has furnished the foundation for a long line of later decisions, that § 3670 of the Internal Revenue Code of 1939 (which creates the federal lien) implicitly incorporated the familiar rule of "first in time, first in right" (p. 87) as a matter of federal law to determine the priority of competing local and federal liens. Accordingly, the Court held, any federal tax liens which attached to the taxpayer's property at an earlier date than the local real-estate-tax and water-rent liens were entitled to a prior right to the proceeds of sale of the property.

Although the facts of the present case are "on all fours" with those of *New Britain*, the New York Court of Appeals has failed to follow this Court's

decision. In the instant case a federal tax lien under sections 3670 and 3671 of the Internal Revenue Code of 1939 indisputably attached to all of Joseph Victory's property, including the real property here in issue, *after* the real property had been mortgaged to Buffalo Savings Bank but *before* any of the state tax liens now asserted had arisen. The United States recognizes the priority of the mortgage lien but claims that its tax lien, which arose prior in time to any local lien for taxes or water rates, is prior in right to any such local lien. The New York Court of Appeals afforded priority to the concededly later-arising state tax liens in a decision which wholly fails to distinguish the *New Britain* case.

A. It is clear beyond reasonable dispute that in *New Britain* this Court was faced with and deliberately resolved the very question of circularity of state and federal liens that is alone in issue in this case. See 347 U.S. at 87-88. In *New Britain* state law granted the local tax liens a priority over mortgage liens. Federal law, as there determined by this Court, resulted as to certain federal liens in establishing the following order of priority: (1) mortgage lien; (2) federal tax lien; (3) state tax lien. Both the Connecticut Supreme Court of Errors and this Court agreed that no provision of federal

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As noted above, federal law applies the traditional rule of "first in time, first in right" to determine the relative priorities of perfected state and federal tax liens. The same rule, as modified by the notice requirements of section 3672 of the 1939 Internal Revenue Code and of section 6323 of the 1954 Code applies to determine relative priorities between the federal lien and the rights of certain specific parties (mortgagees, pledgees, purchasers, and judgment creditors).

law prevented the state from giving priority to various state liens (such as tax and water-rent liens) over mortgages and judgments. It therefore was apparent that a mortgagee would enjoy the full benefits of its mortgage only if the federal lien were subordinated to any state lien which the state chose to make prior in right to a mortgage lien. This Court took careful note of this inevitable consequence but nevertheless unequivocally concluded that federal rules alone determine the priority of the federal tax lien and that these rules are unaffected by any burden of subordination the state may choose to impose upon the mortgage lien which the federal statute respects. The Court held that (347 U.S. at 88):

> The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. There is nothing in the langage of § 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein, and the legislative history lends support to this impression.

In sum, federal law was held to determine the relative priority of a federal tax lien vis-a-vis any and all state liens, regardless of inconsistent state law. State law was left free to determine the relative priorities of non-federal liens among themselves.

B. The facts of the present case are indistinguishable from those of *New Britain*. The distinctions ventured by the New York Court of Appeals are patently frivolous.

(1) First, the New York Court has held that the federal lien reaches only the mortgagor's interest *at the time of foreclosure* while the state liens attach to the mortgagor's interest prior to the time of foreclosure. (App. A, pp. 17, 18, 20, 21, 24, 28.) An alternative statement of the same argument is that the federal lien reaches only the state-defined "surplus" available to the mortgagor at the time of foreclosure while "[t]he local government lien is not a levy against the mortgagor, but against the land * * *" (App. A, pp. 17, 19.) However, the statute itself provides a conclusive answer to this purported distinction. Section 3670 and 3671 of the Internal Revenue Code of 1939 state in the clearest terms that a lien upon all of the taxpayer's real and personal *property*—not that part of his property free of state liens, nor, much less, the unforeseeable surplus from the sale of his property—arises at the time the assessment list is received by the collector. Indeed the entire presupposition of the federal rule of "prior in time, prior in right" is that the federal tax lien attaches to the taxpayer's property at the time the assessment list is received by the collector and not to the surplus after foreclosure. If this were not so, every perfected state lien on a particular piece of property would be prior to any federal tax lien regardless of the date at which the state lien arose.

(2) A closely related argument of the New York Court of Appeals attaches significance to the fact that the state lien, "[a]s a lien for taxes for essential services applied for the benefit of the land", "attached directly to the particular parcel of real property", while the federal lien attaches "because of an unconnected indebtedness of the owner of the land" (App. A, p. 20). This argument too was considered and rejected on identical facts in *United States v. New Britain, supra*, where this Court stated (347 U.S. at 84):

> * * * we accept the holding as to the specificity of the City's liens since they attached to specific pieces of real property for the taxes assessed and water rent due. * * * The federal tax liens are general and, in the sense above indicated, perfected. But the fact that one group of liens is specific and the other general in and of itself is of no significance in these cases involving statutory liens on real estate only. *United States v. City of Greenville*, 118 F. 2d 963, 964. * * *
>
> Thus, the general statutory liens of the United States are as binding as the specific statutory liens of the City. The City gains no priority by the fact that its liens are specific while the United States' liens are general. * * *

(3) Finally, the New York Court of Appeals relies upon the fact that under state law payment of local taxes, assessments, and water rates is termed an expense of a foreclosure sale. However, whatever may be the priority status of the actual costs of disposing of encumbered property, it is clear that a state cannot alter the federal rules of priority of

liens by merely designating a particular type of state lien (which is totally unrelated to the actual costs of sales of encumbered property) as an "expense" of foreclosure. To recognize any such state power to determine priorities by a mere change in terminology is to authorize the state to subordinate earlier-arising federal tax liens to any state-created lien the state chooses to call an expense of foreclosure.

Certainly there is nothing in the opinion of this Court in *United States* v. *Brosnan*, 363 U.S. 237, which affords support for this distinction. *Brosnan* dealt solely with the right of a senior mortgagee to divest the claims of junior lienors (including the United States) under state-authorized procedures, without recourse to a judicial sale. This Court was not asked to consider and did not pass upon the validity or effect of the sheriff's payment of local taxes incident to the sale, for the only contested issue involved the propriety of the state *procedures* for foreclosure. The opinion is replete with reaffirmations of the principle—fundamental to the law of federal tax liens—that a federal rule which is found in Section 3670 determines the relative priorities of State and federal liens when the federal lien has attached to what is incontestably the taxpayer's property. 363 U.S. at 240, 241. The *Brosnan* case adopts state law for the sole purpose of authorizing the use of state procedures for foreclosure.

II.

The present decision of the New York Court of Appeals in conflict with the decisions of the Fourth

Circuit in *United States* v. *Bond*, 279 F. 2d 837, certiorari denied, 364 U.S. 895; the Ninth Circuit in *United States* v. *Christensen*, 269 F. 2d 624; the First Circuit in *United States* v. *Wasserman*, 257 F. 2d 491; the decision of the Supreme Court of Michigan in *Union Central Life Ins. Co.* v. *Peters*, 301 Mich. 283, 105 N.W. 2d 196, reversed on other grounds, *sub nom. United States* v. *Union Central Life Ins. Co.*, 368 U.S. 291; and the decision of the Wisconsin Supreme Court in *First Nat. Bank of Chippewa Falls* v. *Hennaman Co.*, 10 Wis. 2d 260, 103 N.W. 2d 24, certiorari denied, 364 U.S. 836. See also *Southern Ohio Savings Bank & Trust Co.* v. *Bolce*, 165 Ohio St. 201, 125 N.E. 2d 217; and *Stadelman* v. *Hornell Woodworking Corp.*, 172 F. Supp. 156 (W.D.N.Y.).

In each of those cases as in *New Britain*, *supra*, and as in the instant case, an earlier-arising federal tax lien was accorded priority over state tax liens although, under state law, the state tax lien could apparently be satisfied at the expense of a mortgagee whose claim was prior to that of the United States under federal law. Moreover, in each of those cases a specific local tax lien, which related directly to obligations flowing from ownership of the encumbered property, was held, following *New Britain*, to stand on a par with the general federal lien which resulted from a federal tax debt unrelated to the particular land in question. The facts of these cases differ from those of the present case only in that a New York statute provides that all taxes, assessments, and water rates which are paid out of the proceeds of a foreclosure sale shall be "deemed expenses of the sale within

the meaning of that expression as used in any provision of this article." (Civ. Prac. Act, § 1087, App. B, p. 41). That choice of labels—which is, of course, perfectly proper when used for the purpose of determining consequences controlled by state law—cannot be considered as a justification for subordinating an earlier-arising federal lien without overruling the firmly established principle that the priority of a federal tax lien is a question of federal law.

III

The question presented is of great importance to the administration of the internal revenue laws and to the collection of the federal revenue. In the eight months prior to February 28, 1962, the federal government filed 2211 notices of federal tax liens in New York. The effectiveness of those liens and of the far greater number filed in earlier periods and still outstanding is cast in serious doubt by the decision of the New York Court of Appeals.

CONCLUSION

To protect the integrity of this Court's *New Britain* decision, to resolve a conflict between the decision of the highest court of New York and the uniform contrary decisions of three courts of appeals and of two state supreme courts, and to determine the effectiveness of a very large number of federal liens in the State of New York, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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APRIL 1962.

APPENDIX A

BUFFALO SAVINGS BANK, Appellant, *v.* BEVERLY VICTORY, Individually and as Administratrix of the Estate of JOSEPH VICTORY, Deceased, et al., Defendants, and UNITED STATES OF AMERICA, Respondent

Decided February 22, 1962

BURKE, J. The issue here is whether the payment of local real estate taxes and assessments as expenses of sale, rather than the application of that amount toward the payment of a Federal lien filed against the mortgagor prior to the accrual of local taxes, disregards the alleged right of the tax lien of the United States to prior payment.

We find that the Federal tax lien is not entitled to priority over subsequently accrued local tax liens—superior to the mortgage debt—since the respective liens are not comparable charges on real property and the "mortgagee" has an absolute preference over Federal liens.

Plaintiff commenced this action in October, 1958 to foreclose its real property mortgage given by Joseph B. Victory, dated and recorded April 5, 1946. At the time of verification of the complaint there was a balance due on the bond of $1,473.75, with interest at the rate of 5% per annum from January 10, 1958. The United States was *made a party because of a tax lien it filed in the Erie County Clerk's office January 15, 1953 against the mortgagor, since deceased.* Its answer stated a balance due on the lien of $689.07, plus interest. Plaintiff did not advance

any sums for payment of local real property taxes and assessments, which became liens upon the land on and after July 1, 1957.

The mortgagee moved for summary judgment providing that the premises be sold free of the United States tax lien, but *subject* to all real property taxes and assessments. This motion was granted by the Erie County Court. On appeal by the respondent, the Appellate Division reversed and remitted the case to the County Court, stating that the discretionary authority to have the property sold *subject* to all local real estate taxes "may not properly be exercised in a case such as this in which there is a problem of circular priorities" (11 A D 2d 160). Thereafter the County Court once more granted summary judgment in favor of the mortgagee providing that the premises be sold and directing that the Referee "shall, as a part of the expenses of the sale, pay out of the proceeds of said sale all real estate taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid real estate taxes, assessments or water rates which have not apparently become absolute". The judgment further foreclosed all rights, liens, and equities of redemption in the premises, except as to the one-year period of redemption granted to the United States by section 2410 of title 28 of the United States Code.

On appeal by the United States, the Appellate Division modified the judgment by providing that "the rule of priorities laid down in *United States* v. *New Britain* (347 U.S. 81) applies" (13 A D 2d 208), and that the local tax liens were not to be paid as expenses of the sale.

The appellant mortgagee contends that the fore-

closure procedure of New York is determined by our State law and that a direction to pay local taxes and assessments as expenses of the sale was a proper direction within section 1087 of the New York Civil Practice Act. The United States contends that this court is barred from reaching a determination reversing the Appellate Division and affirming the judgment of Erie County Court. (*United States* v. *New Britain*, 347 U.S. 81.)

Although the United States Supreme Court in recent years has passed on the question of priority of liens and the resulting effect upon mortgagees, their decisions provide no clear command governing us here.

The case of *United States* v. *New Britain* (*supra*) is distinguishable from the present case.

There the Supreme Court assumed, in the posture of the case as it reached that court, that the contest was between the local government and the Federal Government over their respective rights in surplus funds.

In the usual case, as here, however, the state of facts shows that the dispute is really between the mortgagee and creditors of the mortgagor. The debts of the mortgagor obviously can only be satisfied out of such equity in the real property as the mortgagor may have. When the property is sold in foreclosure, the equity of the mortgagor is extinguished except in the event the bid provides a surplus. Any interest of the mortgagor is fully protected. The mortgagor can bid at the sale, bring surplus money proceedings and resist a deficiency judgment by adducing proof that the value of the property exceeded the bids. In New York State the local government is not paid out of the surplus as the mortgage is subject to its liens, but the Federal Government as a creditor of the mort-

gagor can look only to the surplus for the satisfaction of its lien. The local government lien is not a levy against the mortgagor, but against the land and must be paid together with other costs from whatever funds the sale of the land produces before (if there were no creditors of the mortgagor) any claimed interest of the mortgagor could be asserted. Our State law has not characterized the nature and extent of the Federal tax lien, but has determined the nature and extent of the property interests of the taxpayer (admittedly a State function), which in the case of real property is conditioned upon the payment of annually recurring governmental land taxes, the payment of which may not be avoided by a foreclosure sale. Of course, the Federal Government's claim, which is based on the claimed interest of the mortgagor, can have no better standing, that is, the Federal lien is also to be paid when there is a surplus in which the mortgagor would have an interest. It would manifestly be unjust to require a mortgagee to pay a creditor of a mortgagor when it appears that the mortgagor had no equity in the real property.

In the *New Britain* suit (*supra*) the court, at the outset, held that the contestants were vying over rights to funds which were considered as surplus. Federal liens securing unpaid withholding and unemployment taxes and insurance contributions owed by the mortgagor attached to his interest in the property subsequent to two mortgages and a judgment lien, but prior to city liens for unpaid real estate and water taxes. Connecticut law provided that the statutory liens for real estate taxes and water rent took precedence over all other liens or incumbrances. Mr. Justice MINTON, speaking for the court, conceding that the mortgagee had a preference, stated

at pages 85–86: "It does not follow, however, that the City's liens must receive priority as a whole. We believe that priority on these statutory liens is determined by another principle of law, namely, 'the first in time is the first in right.' * * * We think that Congress had this cardinal rule in mind when it enacted § 3670, a schedule of priority not being set forth therein. Thus, the priority of each statutory lien contested here must depend on the time it attached to the property in question and became choate."

Although it may have been the clear intent of Congress that this Federal tax lien have a priority determined by the timeliness with which it attached to the interest of the mortgagor in the real property, *New Britain* does not indicate that it was the intent of Congress to upset established State procedures in foreclosure actions or curtail the absolute preference granted to mortgagees. The statement (p. 88) that "The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors" is far too removed, in the light of the real issue here, from the court's interpretation of congressional intent to have any relation thereto.

Not to be lost sight of in its discussion of the relative priority of the liens is the court's statement that Congress intended to assert the Federal lien "as to any funds *in excess of the amount* necessary to pay the mortgage and judgment creditors." (*United States* v. *New Britain*, 347 U.S. 81, 88, *supra;* italics supplied.) The Supreme Court there recognized that the mortgagor's interest in the proceeds of the foreclosure sale, and consequently the United States lien, reaches only surplus moneys.

But such surplus funds cannot be created by the judgment, for they are the moneys paid for the land in excess of the amount decreed in the judgment. A judgment which omits an item of sale expense in order to create a surplus fund to which subsequent liens can attach violates the statute. Rights of lienors in surplus funds are to be protected, but the law of this State cannot be subverted to create a surplus where none might otherwise exist. Our State law does not prevent such lienors from bidding at a foreclosure sale in order to protect their liens; but, inasmuch as they are not forced to bid a sum which will create a surplus, it would be inequitable to force the foreclosing mortgagee to bid an inflated price creating a surplus through the scheme of "circular priorities".

In this case the respondent's claim that its lien, founded on the interest of the defaulting mortgagor in the real property, should be granted a priority over the lien on the land, concededly superior to not only the mortgagor's interests in the realty but the mortgagee's interest as well, depends on the obviously fallacious contention that the lien of the municipality upon the land is akin to the lien of the Federal Government as a creditor of the mortgagor. The plain answer is that the Federal Government is only the creditor of a debtor whose interest in the land is subordinate to the local government lien, which need not be reduced to judgment nor perfected by a filing in the County Clerk's office. As a lien for taxes for essential services supplied for the benefit of the land, it attached directly to the particular parcel of real property. The Federal lien was filed in the Clerk's office against a presumed equity in

the real property held by the mortgagor. This respondent imagines a surplus, which is as yet non-existent, against which it would press a lien arising from a debt owed to it by the mortgagor. But in a foreclosure suit the equity of the mortgagor upon which a Federal lien depends should be established according to law, not by an ipse dixit.

The real estate tax and water-rent liens are not liens which attach to the property merely because of an unconnected indebtedness of the owner of the land, as are Federal tax liens. The property itself, in its very nature as land, incurs the indebtedness. It matters not who owns the land for, even if the United States in foreclosing its lien had a Receiver appointed to sell the land, the property could not have been transferred free and clear of the local tax liens attaching while the United States was in possession (see *Borock v. City of New York*, 268 F. 2d 412).

Thus, the circumstances in the present case are quite different from those assumed in *United States* v. *New Britain* (*supra*). The question is not "the relative priority of statutory federal and municipal liens to the proceeds of a mortgage foreclosure sale of the property to which the liens attached" (*United States* v. *New Britain*, *supra*, p. 82), but whether the payment of the Federal lien filed against the mortgagor should be mandated where there is no evidence that the mortgagor has a financial interest at the time of foreclosure. Here we are faced with the true parties in interest—the mortgagee and the Federal Government. Under New York law no funds are deemed surplus until the expenses of the sale, the costs of the action and the amount of the foreclosed mortgage debt plus interest have been fully paid. (Civ. Prac. Act,

§ 1082). The procedure in this State requires the officer conducting the foreclosure sale to pay out of the proceeds all taxes, assessments and water rates which are liens on the property, unless the judgment directs otherwise. These payments are expenses of the sale by statute. Therefore, the question of what, if any, financial interest the mortgagor-taxpayer had on which the Federal Government had a lien can only be determined under the State law after the foreclosure sale.

The procedure adopted by the Appellate Division does not follow New York State procedure. Up to the present time the expenses of sale have always been determined by State, rather than Federal, law, and even the judgment in *New Britain (Brown v. General Laundry Serv.*, 19 Conn. Supp. 335) recognized that the expenses of sale have priority over any other claim to the moneys realized on the sale. Certainly precedent demands that we should reaffirm the principle that State procedures govern.

Moreover, the Supreme Court in a recent decision has allowed State law to control the procedure of foreclosure and payment of liens. In *United States* v.

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[1] (Civ. Prac. Act, § 1087)—"Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold and redeem the property sold from any sales for unpaid taxes, assessments or water rates, which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. The provisions of this section shall not apply to any judgment in an action wherein any municipal corporation of this state is the plaintiff and the purchaser at the foreclosure sale thereunder."

Brosnan (264 F. 2d 762, affd. 363 U.S. 237) Federal tax liens attached to property subject to a purchase-money mortgage, but prior to local tax liens.[2] Upon default in payment of the mortgage, the mortgagee caused a confession of judgment to be entered on the bond. A writ of *fieri facias* for the sale of the property issued to the Sheriff. The United States was not a party to this action. "The sheriff held the sale of the property on January 3, 1956; it was bid in by Brosnan and Jacob [assignees of the mortgagee] for $6,203 and, it is presumed, the discharge of the mortgage indebtedness. *The amount of the bid went to satisfy* costs of the sale, and for various outstanding local taxes." (264 F. 2d 764; emphasis supplied.)

More than a year later the United States brought an action to enforce its lien, but the District Court (164 F. Supp. 357) and the Court of Appeals for the 3d Circuit (264 F. 2d 762, *supra*) held that the junior lien of the Government was extinguished even though the United States had not been joined as a party. The Supreme Court affirmed the determinations below (363 U.S. 237). The opinion was replete with references to State law and procedure—something not found in *New Britain*.

The Supreme Court's attention was drawn to the fact that Pennsylvania gave its own tax liens more favorable treatment than it rendered the Federal liens at pages 25 to 27 of the United States' brief: "Indeed, Pennsylvania law itself treats state tax liens more favorably than federal tax liens. A Pennsylvania

[2] The Federal liens, amounting to $40,303.34, attached to the property between April 11, 1949 and November 28, 1951 (Exhibit B to complaint of United States). The local taxes paid out of the proceeds of the sale were county, township and school taxes for the period 1952–1955 in the amount of $5,756.90 (Transcript of Record, p. 22).

statute provides that 'The lien of all taxes * * * against any real estate within this Commonwealth shall be divested by any judicial sale of such land: Provided, The amount of the purchase money shall equal the amount of the said taxes'. (Purdon's Penna Statutes Annotated, Title 53, Section 7104, Appendix, *infra*, p. 36). While Pennsylvania law permits discharge of a junior lien on realty through foreclosure of a prior mortgage at a sheriff's sale, the Commonwealth's liens may be divested only to the extent permitted by statute [cases cited]. Thus, under Pennsylvania law the state's tax lien will be discharged through foreclosure only if the state's tax claim is paid in full out of the proceedings. The decision below holds, however, that the same foreclosure proceeding wipes out the federal lien even though the United States receives not a single penny toward payment of its claim."

The dissent makes it clear that the objection to Pennsylvania procedure in extinguishing the lien of the Federal Government was not that it was done according to State procedure, but that Pennsylvania procedure did not provide for notice to junior lienors (363 U.S. 261).

Although the main facet of the *Brosnan* case was a sanction of Pennsylvania's procedure, whereby the United States was not required to be a party to the action in order to extinguish its lien, the affirmance also necessarily sanctioned that State's procedure of paying local taxes out of the proceeds of the sale without the necessity of creating a surplus with which to pay liens prior to the local tax liens. (Purdon's Pennsylvania Statutes Ann., tit. 53, §§ 7103–7105.) This is a departure from the holding in the *New Britain* case, as that case is construed by the respondents. The Supreme Court in *Brosnan* also gave

effect to the preference accorded to mortgagees by State and Federal law, and the decision tends toward the principle stated in the dissenting opinion of HAYNSWORTH, J., in *United States* v. *Bond* (279 F. 2d 837, 848, cert. den. 364 U.S. 895).

According to respondent's reasoning, the mortgagee, concededly not under any obligation to pay the Federal lien on the interest of the mortgagor at the time the lien was filed, becomes obligated when it bids in at the foreclosure sale simply because the mortgagee as bidder under State law must bear the cost of unpaid local taxes on the land falling due subsequent to the filing of the Federal lien. This imposition of liability is justified on the assumption that at the time of foreclosure the undetermined financial interest of the mortgagor has a value at least equal to the amount of the unpaid taxes which fell due subsequent to the filing of the Federal lien.

The circumstances present in the case of the foreclosure of a real estate tax lien by a municipality illustrate best the paradoxical result of the application of the rule respondent asserts. Under that rule the municipality which is foreclosing the tax lien for local taxes, which accrued subsequent to the filing of a tax lien filed against the equity of the property owner, shall be obligated to discharge the Federal tax lien in order to secure a clear title. But the interest of such a property owner obviously is worthless, since neither the property owner nor the public would bid on the tax lien which the municipality ultimately had to foreclose. In spite of this evidence of lack of value, the respondent would contend that the Federal lien has a priority because the nonexistent financial interest of the property owner cannot be diminished by giving priority to local taxes accrued subsequent to the filing of the Federal lien and

that, therefore, the municipality must satisfy the Federal lien. In other words, the financial interest of the property owner which was nil develops value through the default of the property owner on local taxes. This *nonsequitur* had to be resorted to because respondent realizes its lien is not a lien on the land, but is only a lien on the equity of the owner. Therefore, it had to invent an equity which the owner could be said to possess at the time of the foreclosure in order to avoid the controlling State law which provides that the nature and extent of the property interests of a defaulting mortgagor can only be determined after a foreclosure sale conducted according to the State laws. The patent infirmity of this contrivance explains why the respondent has improperly invoked a canon in a matter involving disparate liens, which is relevant only to the relationships of kindred liens, i.e., "the first in time is the first in right".

Such a rule, if accepted now, would adversely affect the credit rating of all municipal bonds which are marketed on the assumption that local taxes are a first lien on the land within the municipality. It would also impair the borrowing power of municipalities because it makes the municipality liable for the personal debts a tax delinquent property owner owes to the Federal Government. Finally, it would cloud the title of properties which the municipalities have resold after acquisition through tax lien foreclosures.

The logic of the respondent appears to be as circular as the type of priority that it would have this court stamp with approval. The procedure that it proposes is novel to this State. Were local taxes not owing upon the land, the United States could not, through its own admissions, compel the creation of

a surplus in which its lien would share with the judgment creditors. Is it logical that the Federal Government should be entitled to compel the mortgagee to treat the amount of real estate taxes subsequently accruing as a surplus to be applied toward payment of the Federal lien?

To accede to this attempt to foist the personal debts of the mortgagor owing to the United States on the mortgagee is to agree to the imposition of an indirect tax on savings banks who have invested billions of dollars in mortgages and on the savings of our citizens invested in mortgages which have been accorded a preference even under Federal law (U.S. Code, tit. 26, § 6323, subd. [a]). If the preference is to be whittled down, it should be done explicitly by a statute enacted by the representatives of the States in the national Congress and not by the courts.

The direction in the resettled judgment of foreclosure that the Referee should pay the real estate taxes, assessments and water rates out of the proceeds of the sale as expenses of the sale is not only in conformity with State law (Civ. Prac. Act, § 1087), but is also in keeping with the preference conferred on the mortgagee by State and Federal law protecting "all those rights which the Congress must have known the mortgagee commonly and usually possesses" (*United States* v. *Bond*, 279 F. 2d 837, 851, *supra*). Being the proper procedure of this State, the resettled judgment of foreclosure of October 20, 1960, should be affirmed.

The judgment of the Appellate Division entered June 13, 1961, should be reversed and the judgment of the County Court, Erie County, entered October 20, 1960, reinstated without costs.

FULD, J. (dissenting). By its present decision, the

court is holding that a Federal tax lien filed against a mortgagor prior to the accrual of local real estate taxes and assessments—which are superior to the mortgage debt—is not entitled to priority over those subsequently accrued local liens. I cannot agree. In my view, the conclusion reached by the majority is opposed by controlling authority. (See *United States* v. *New Britain*, 347 U.S. 81; see, also, *United States* v. *Bond*, 279 F. 2d 837 [4th Cir.]; *United States* v. *Christensen*, 269 F. 2d 624 [9th Cir.]; *Stadelman* v. *Hornell Woodworking Corp.*, 172 F. Supp. 156 [U.S. Dist. Ct., W.D.N.Y.]; *United States* v. *Lord*, 155 F. Supp. 105 [U.S. Dist. Ct., N.H.]; *Union Central Life Ins. Co.* v. *Peters*, 361 Mich. 283.) Nor may the impact of such authority be avoided by having the State, through legislative enactment or court decision, label local taxes and assessments "expenses of the sale", that is, of the mortgage foreclosure sale following the action brought by the mortgagee (Civ. Prac. Act. § 1087).

Once it has been determined, under State law, that the taxpayer has property or rights to property, "state law is inoperative to prevent the attachment of liens created by federal statutes in favor of the United States." (*United States* v. *Bess*, 357 U.S. 51, 57.) Moreover, when a Federal tax lien has attached to property of the taxpayer, as undoubtedly it has here, State law may not destroy it. (See *Commissioner* v. *Stern*, 357 U.S. 39.) As already indicated, calling the local taxes "expenses of the sale" does not help the local taxing authority, for it is to substance, not form, that the courts look. Local taxes do not result from the mortgage foreclosure sale; on the contrary, they are pre-existent to the sale. Accordingly, the State's characterization of them as "expenses of

the sale"—appropriate though it may be for the State's own purposes—is thoroughly unreal in our present context and completely ineffectual to affect the priority of the Federal lien. (Cf. *United States v. Gilbert Associates*, 345 U.S. 361.)

In deciding questions concerning the relevant priorities of a Federal tax lien and other liens, it is perfectly clear that State law determines the nature and extent of the property interests of the taxpayer and that Federal law determines the priority of the competing claims themselves. (*See, e.g., Aquilino v. United States*, 363 U.S. 509, 515-516; *United States v. Brosnan*, 363 U.S. 237, 240; *United States v. Bess*, 357 U.S. 51, 55, *supra*; *United States v. Acri*, 348 U.S. 211, 213.) Although the court's opinion herein does not expressly reject this proposition—as to the proper role of State and Federal law in this area—its decision stands squarely opposed to it. What the court has done, under State law, is to characterize the nature and extent of the Federal lien and determine its priority in competition with local liens—a function exclusively reserved to the Federal law. (*See Aquilino v. United States*, 363 U.S. 509, *supra*.) Thus, the majority describes the Government's status in the present action as that merely of "a creditor of the mortgagor" and concludes that, since the Government's position "is based on the claimed interest of the mortgagor, [it] can have no better standing [than the mortgagor], that is, the Federal lien is also to be paid when there is a surplus [over mortgage debt plus local taxes] in which the mortgagor would have an interest" (opinion, p. 37). To employ the language of the opinion in the *Brosnan* case, this is not an authorized State determination of the " 'property and rights to property' * * * to which a govern-

ment tax lien attaches," but rather an unauthorized State determination of "matters directly affecting the nature or operation of [federal tax] liens" (363 U.S. 237, 240).

Furthermore, giving priority to the after-accrued local taxes, as the majority is here doing, is directly contrary to the Supreme Court's decision in *United States* v. *New Britain* (347 U.S. 81, *supra*). In that case, in addition to prior mortgages and a prior judgment lien, the taxpayer's property was incumbered by a Federal tax lien and, subsequent in time to such lien, by a municipal tax lien. The Connecticut Supreme Court reasoned, as the majority does here, that, since Federal law subordinated the Federal tax lien to mortgage and judgment liens and since, under State law, these mortgage liens were subordinated to real property tax liens, the Federal tax lien had to be subordinated to the local real property tax lien. (See *Brown* v. *General Laundry Serv.*, 139 Conn. 363, 373.) In answer to this argument, the Supreme Court of the United States declared (347 U.S., at p. 88):

> "We do not agree. The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgagee and judgment creditors, Congress intended to assert the federal lien."

Even more recently, in *United States* v. *Brosnan* (363 U.S. 237, *supra*), the Supreme Court, citing numerous decisions, "rejected" the very position taken by the majority in this case (363 U.S., at p. 241):

> "This Court has repeatedly rejected the contention that because a fee owned by a taxpayer was already encumbered by a lien which en-

joyed seniority under state law, the Government's lien necessarily attached subject to that lien."

The rule adopted in the *New Britain* case as the Federal rule for resolving conflicts between a Federal tax lien and local real property tax liens is the olden one that " 'the first in time is the first in right' " (347 U.S., at p. 85). As there pointed out, "When the debtor is insolvent, Congress has expressly given priority to the payment of indebtedness owing the United States, whether secured by liens or otherwise, by § 3466 of the Revised Statutes, 31 U.S.C. (1946 ed.) § 191. In that circumstance, where all the property of the debtor is involved, Congress has protected the federal revenues by imposing an absolute priority". Where, however, the court continued (p. 85), "the debtor is not insolvent, Congress has failed to expressly provide for federal priority, with certain exceptions not relevant here". (And see Internal Revenue Code of 1939, U.S. Code, tit. 26, § 3672; Internal Revenue Code of 1954, U.S. Code, tit. 26, § 6323). And, added the court, "There is nothing in the language of § 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein" (p. 88), that is, mortgagees, judgment creditors, pledgees and purchasers. Accordingly, the relative priority of each lien here involved "must depend upon the time [each of them] attached to the property in question and became choate" (p. 86. See, also, *United States* v. *Bond*, 279 F. 2d 837, *supra*; *United States* v. *Christenson*, 269 F. 2d 624, *supra*).

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[1] It is appropriate to note at this point that the record before us, like the record in *New Britain* (347 U.S., at p. 85), does not indicate that the mortgagor-taxpayer was insolvent.

The court seeks to distinguish *New Britain* from the present case on the ground that the contest there "was between the local government and the Federal government over their respective rights in surplus funds", whereas here the "facts [show] that the dispute is really between the mortgagee and creditors of the mortgagor" (opinion, p. 36). Starting from this premise, the majority urges that, if the contest were between the Federal Government and the local taxing authorities, *New Britain* would control and the Government would prevail. But, since the dispute here is between the United States, as a creditor of the mortgagor, and the mortgagee, the latter must prevail, because (the argument proceeds) the Government can have no better standing than the mortgagor himself. And the court seeks to bolster this conclusion by claiming that "the respective liens [in this case] are not comparable charges on real property" (p. 35). In my judgment, the proffered ground for distinction is not tenable.

It is true that in *New Britain* the contest was between the city and the Federal Government but, as the facts disclosed and later developments made clear (see *Brown* v. *General Laundry Serv.*, 19 Conn. Supp. 335), the real parties in interest were the Federal Government and private lienors of the debtor's real estate who were entitled to priority over the Federal lien by the express terms of the Federal lien statutes. The State of Connecticut received its taxes in full at the expense of lienors whose liens were prior to those of the Federal Government. The fact that the contest in *New Britain* was between the city and the Federal Government and in this case between the mortgagee and the Government neither compels nor justifies a difference in result.

As I have already noted, it is the majority's assertion that the lien for local taxes must take precedence over the Government's lien because the respective liens are not comparable charges on real property. This is its position (pp. 36–38): on the one hand, "The local government lien is not a levy against the mortgagor, but against the land." On the other hand, the Federal Government's status is only that of "a creditor of the mortgagor", its claim merely one "based on the claimed interest of the mortgagor". And its lien, rather than being a lien which "attach[es] directly to the particular parcel of real property", as does that of the local government, "attach[es] to the property merely because of an unconnected indebtedness of the owner of the land". In other words, the Federal lien is not against the land, but "against a presumed equity in the real property held by the mortgagor."

Having made these distinctions, the court goes on to suggest that the difference in the way these liens arise assures priority to the liens of the local taxing authorities over the lien of the Federal Government. From this and the status ascribed to the Federal lien, it is the court's conclusion that "the Federal government's claim, which is based on the claimed interest of the mortgagor, can have no better standing [than the mortgagor's claim], that is, the Federal lien is also to be paid when there is a surplus [above the mortgage debt and expenses of sale, including local taxes] in which the mortgagor would have an interest" (opinion, p. 37).

The fallacy of this argument, I venture, is that it mistakes the Federal law with respect to the status and incidence of the Federal interest. The Federal Government is no mere unsecured creditor of a delinquent taxpayer. It is, rather, the holder of "a

lien * * * upon all property or rights to property, whether real or personal, belonging to such person" (Internal Revenue Code of 1954, U.S. Code, tit. 26, § 6321). Such a lien attaches to the real property owned by the taxpayer at the time the "[tax] assessment is made" (U.S. Code, tit. 26, § 6322), not to whatever equity he may have in it after a subsequent mortgage sale. In short, the Federal lien is not, as the majority insists, "against a presumed equity in the real property held by the mortgagor", but against the land itself. The rights of the Federal Government to the proceeds of the mortgage sale are not, therefore, limited to those of the mortgagor.

Let me state the matter somewhat differently. The lien of the United States arose when the assessments were made, and it attached to the mortgaged property at that time. Consequently, if the sale of the property had then been held, that lien could have been satisfied out of the proceeds of such sale after payment of proper expenses and of the amount then due on the mortgage plus interest to the date of payment. The local taxes here involved had not yet come into being and might never have become liens against the property. They might have been paid by the mortgagor or the property might have been foreclosed before they became due. Since, therefore, the liens of the local authorities had at best only a potential existence, we do not reach the question whether those liens were choate when the Federal liens attached. It comports neither with reality nor with law to give such "potential liens" priority over the pre-existing matured Federal lien by labeling them "expenses of the sale" in foreclosure proceedings.

Indeed, an argument very similar to that made by the court here, namely, that the respective charges of the Federal Government and the local taxing authorities are "not comparable charges on real property", was expressly made and rejected in the *New Britain* case (347 U.S. 81, *supra*). It had evidently been argued that the local tax liens should take precedence over the Federal tax lien because they were "specific" while the Federal lien was "general". With respect to this contention, the Supreme Court declared (p. 84):

> "[T]he fact that one group of liens [the local] is specific and the other [the federal] general in and of itself is of no significance in these cases * * *. Thus, the general statutory liens of the United States are as binding as the specific statutory liens of the City. The City gains no priority by the fact that its liens are specific while the United States' liens are general."

Finally, a word must be said about the majority's characterization of the decision in *United States* v. *Brosnan* (363 U.S. 237, *supra*) as "a departure" from the holding in the *New Britain* case. In the first place, *Brosnan* was concerned with a question whether a Federal tax lien could be extinguished under a State procedure for foreclosure in which the Federal Government, *a junior lienor*, was not, and need not have been, a party: what was involved, therefore, was not the problem of priority at issue here. In the second place, although local taxes had been paid out of the proceeds of the mortgage sale and thus had, in effect, achieved priority, that issue was never raised on appeal, the sole issue being—to cull from the court's opinion— "whether the federal lien was effectively extinguished by state

proceedings to which the United States was not, nor was required under state law to be, a party" (363 U.S., at pp. 238–239). The third and (to me) conclusive reason why *Brosnan* may not be taken to be a departure from the *New Britain* holding is that in *Brosnan* the Supreme Court actually cited *New Britain* with approval (363 U.S., at p. 241, n. 4) and restated one of the principles which it had announced; thus, it wrote in *Brosnan* (p. 241): "This Court has repeatedly rejected the contention that because a fee owned by a taxpayer was already encumbered by a lien which enjoys seniority under state law, the Government's lien necessarily attached subject to that lien". As is evident, far from supporting the majority view in the present case, the opinion in *Brosnan* stands with *New Britain* to refute it.

In sum, then, in situations of this kind, the lien of the Federal Government must be recognized as prior in right to that of the local taxing authorities. This follows from the fact that it is prior in time. But this does not mean that those local taxing authorities will not collect their taxes. The majority opinion has placed the contest in its proper setting. The dispute is between the mortgagee and the Federal Government as a creditor of the mortgagor. The local taxing authorities will be paid at the expense of the mortgagee so there will be no adverse economic impact upon the taxing authorities. The mortgagee's interest in the proceeds of the mortgage sale may, perhaps, be diminished. But the mortgagee is not left without recourse where the mortgagor is liable for payment of the debt secured by the mortgage and he is not insolvent. In such a case, the mortgagee may collect the "residue" or balance due from the mortgagor by

way of a deficiency judgment (Civ. Prac. Act, §§ 1082, 1083).

I would affirm the judgment of the Appellate Division.

Chief Judge DESMOND and Judges DYE, FROESSEL and VAN VOORHIS concur with Judge BURKE; Judge FULD dissents in an opinion in which Judge FOSTER concurs.

Judgment of Appellate Division, entered June 13, 1961, reversed and judgment of the County Court, Erie County, entered October 20, 1960, reinstated, without costs.

Court of Appeals

State of New York, ss:

PLEAS in the Court of Appeals, held at Court of Appeals Hall, in the City of Albany, on the 22nd day of February in the year of our Lord one thousand nine hundred and sixty-two; before the Judges of said Court.

WITNESS, The HON. CHARLES S. DESMOND, Chief Judge, *Presiding*. RAYMOND J. CANNON, *Clerk*.

REMITTITUR, February 22, 1962.

BUFFALO SAVINGS BANK, APPELLANT

vs.

BEVERLA VICTORY, INDIVIDUALLY &C., & ORS., &C., DEFENDANTS

UNITED STATES OF AMERICA, RESPONDENT

Be it remembered, That on the 27th day of September in the year of our Lord one thousand nine hundred and sixty-one, Buffalo Savings Bank, the appellant—in this cause, came here unto the Court of Appeals, by Little & Burt, its attorneys, and filed in the said Court a Notice of Appeal and return thereto from the judgment of the Appellate Division of the Supreme Court in and for the Fourth Judicial Department. And United States of America, the respondent—in said cause, afterwards appeared in said Court of Appeals by Neil R. Fammelo, its attorney.

Which said Notice of Appeal and the return thereto, filed as aforesaid, are hereunto annexed.

Whereupon, The said Court of Appeals having heard this cause argued by Mr. John H. Little, of counsel for the appellant, and by Mr. C. Donald O'Connor, of counsel for the respondent, briefs filed by amici curiae and after due deliberation had thereon, did, order and adjudge that the judgment of the Appellate Division of the Supreme Court appealed from herein entered June 13, 1961, be and the same hereby is reversed and the judgment of the County Court, Erie County, entered October 20, 1960, reinstated, without costs.

And it was also further ordered, that the record aforesaid, and the proceedings in this Court, be remitted to the County Court, Erie County, there to be proceeded upon according to law.

Therefore, it is considered that the said judgment be reversed &c., as aforesaid.

And hereupon, as well the Notice of Appeal and return thereto aforesaid as the judgment of the Court of Appeals aforesaid, by it given in the premises, are by the said Court of Appeals remitted into the County Court, Erie County, before the Judges thereof, according to the form of the statute in such case made and provided, to be enforced according to law, and which record now remains in the said County Court, before the Judges thereof, &c.

RAYMOND J. CANNON,
Clerk of the Court of Appeals of the State of New York.

COURT OF APPEALS, CLERK'S OFFICE,
Albany, February 22, 1962.

I hereby certify, that the preceding record contains a correct transcript of the proceedings in said cause in the Court of Appeals, with the papers originally filed therein; attached thereto.

RAYMOND J. CANNON,
Clerk.

APPENDIX B

Internal Revenue Code of 1939:

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

(26 U.S.C. 1952 ed., Sec. 3670.)

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

(26 U.S.C., 1952 ed., Sec. 3671.)

SEC. 3672 [as amended by Sec. 401 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 505 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien without Notice.*—Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) *Under state or territorial laws.*—In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by

law authorized the filing of such notice in an office with the State or Territory; or

* * * * * *

(26 U.S.C., 1952 ed., Sec. 3672(a).)

New York Civil Practice Act:

SEC. 1082. *Final judgment; surplus moneys.*

1. In an action to foreclose a mortgage upon real property, if the plaintiff becomes entitled to final judgment, it must direct the sale of the property mortgaged or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale and the costs of the action except as provided in subdivision two of this section. All surplus moneys arising from the sale of mortgaged premises under any judgment shall be deposited by the officer appointed to conduct the sale of the premises within five days after the same shall be received and be ascertainable to the credit of the action in a bank or trust company named by the court in the final judgment unless otherwise specially directed, subject to the further order of the court; and every judgment in foreclosure shall contain such directions, except where other provisions are made specially by the court. * * *.

SEC. 1087. *Payment of taxes, assessments and water rates out of proceeds of sale.*

Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. * * *.

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IN THE

Supreme Court of the United States

October Term, 1962

No. [illegible]

UNITED STATES OF AMERICA,
Petitioner,

v.

BUFFALO SAVINGS BANK.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF BUFFALO SAVINGS BANK IN OPPOSITION

JOHN HORACE LITTLE,
Attorney for Buffalo Savings Bank,
545 Main Street,
Buffalo 3, New York.

BUFFALO LAW PRINTERS,
BUFFALO, N. Y.

INDEX

	PAGE
Opinions below	1
Jurisdiction	2
Questions presented	2
Statutes involved	2
Statement	3
Argument	5
I. The New Britain Case Does Not Apply Here	5
II. The Brosnan Case Does Apply	6
III. The Federal Lien Attached To The Mortgaged Property Subject To The Mortgagee's Right To Have Local Taxes and Assessments Paid Out of the Mortgaged Property	7
IV. The New York Court of Appeals Decision Is Not In Conflict With Any Federal Court Decisions	9
Conclusion	10
Appendix A	11

CITATIONS

Cases:

Aquilino v. United States, 363 U. S. 509, 4 L. Ed. 2 1365	7
Brown v. General Laundry, 19 Conn. Supp. 335, 113 A. 2d 601	4

PAGE

Crest Finance Co. vs. United States, 368 U. S. 387, 7 L. Ed. 2d 342 9

First National Bank v. Henneman Co., 10 Wisc. (2) 260, 103 N. W. (2) 24 9

Julia M. W. Gault v. Jason Bacon, 142 Conn. 200, 113 A. 2d 145 5

Security Mortgage Co. v. Powers, 278 U. S. 149, 73 L. Ed. 236 9

Union Central Life vs. Peters, 361 Mich. 283, 105 N. W. (2) 196 9

United States v. Bond, Fourth Circuit, 279 F. 2d 837. 8, 9

United States v. Brosnan, 363 U. S. 237, 4 L. Ed. 2d 1192 ..... 6, 7, 10

United States v. Christensen, Ninth Circuit, 269 F. (2) 624 9

United States v. Durham Lumber Co., 363 U. S. 522, 4 L. Ed. 2d 1371 7

United States v. City of New Britain, 347 U. S. 81, 98 L. Ed. 520 ..... 4, 5, 9, 10

United States v. Wasserman, First Circuit, 257 F. (2) 491 9

Statutes:

Title 26 U. S. C. Section 3670 2

Title 26 U. S. C. Section 3671 2

Title 26 U. S. C. Section 3672 (a)(1) 2, 5

Title 28 U. S. C. Section 1652 ..... 2, 6

Title 28 U. S. C. Section 2410 (c) 2, 3, 4, 6, 8

New York Civil Practice Act, Section 1082 ..... 2, 5, 8

New York Civil Practice Act, Section 1087 ..... 2, 3, 4, 5, 6, 8

New York Real Property Law, Section 240 (2) 3, 7

New York Real Property Law, Section 290 (3) 3, 7

New York Code of Civil Procedure 1626 ..... 3, 5, 6

PAGE

New York Code of Civil Procedure 1676 ..... 3, 6
General Statutes of Connecticut, Title 49, Chapter 846, Sections 49-27 and 49-29 ..... 3, 5
Wisconsin Statutes, Chapter 278.10 ..... 3, 10

Miscellaneous:
House of Representatives Report 95, 71st Congress, 2nd Session 8

IN THE

Supreme Court of the United States

October Term, 1961

No. 922

UNITED STATES OF AMERICA,

Petitioner,

v.

BUFFALO SAVINGS BANK.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF OF BUFFALO SAVINGS BANK IN OPPOSITION

Opinions Below

The first opinion of the Erie County Court is reported in 186 N. Y. S. 2d 960, 17 Misc. 2d 564 (R. 68-75). The first opinion of the New York Supreme Court, Appellate Division, Fourth Department, is reported at 202 N. Y. S. 2d 70, 11 A. D. 2d 158 (R. 40-44). The second opinion of the Erie County Court is reported at 206 N. Y. S. 2d 518, 26 Misc. 2d 443 (R. 29-39). The second opinion of the New York Supreme Court, Appellate Division, Fourth Department, is reported at 215 N. Y. S. 2d 189, 13 A. D.

2d 207 (R. 115-120). The opinion of the Court of Appeals of the State of New York is reported at 11 N. Y. 2d 31.

Jurisdiction

The judgment of the Court of Appeals of the State of New York was entered February 22, 1962. The petition for a writ of certiorari was filed on April 30, 1962. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1257 (3).

Questions Presented

Whether the United States, when it submits to the jurisdiction of a New York Court under the provisions of Title 28 U. S. C. Section 2410 (c) (Appendix A) in a mortgage foreclosure action, is bound by the provisions of the New York Statutes which make the cost of real estate taxes and assessments paid by the referee expenses of sale, so that they are paid from the proceeds of the sale before any amount thereof is paid either to the plaintiff-mortgagee or to the United States on its federal tax lien; and further whether the United States is bound by other New York statutes as they define the mortgagor's interest in the mortgaged property after the execution of the mortgage as being subject to the right of the mortgagee to have the real estate taxes and assessments paid out of the mortgaged property; and further as said statutes define surplus monies.

Statutes Involved

Sections 3670, 3671 and 3672 (a) (1) of Title 26, U. S. C., 2410 (c) of Title 28, U. S. C., and 1652 of Title 28 U. S. C.; Sections 1082 and 4087 of the New York Civil

Practice Act; Sections 240 (2) and 290 (3) of the New York Real Property Law; General Statutes of Connecticut, Title 49, Chapter 846, Sections 49-27 and 49-29; Wisconsin Statutes, Chapter 278.10; and Sections 1626 and 1676 of the Code of Civil Procedure of the State of New York, predecessor to the New York Civil Practice Act, adopted by Chapter 178 of the Laws of 1880.

Statement

This is an action brought to foreclose a mortgage on real property. The mortgage was dated April 5, 1946, and recorded in Erie County Clerk's Office, New York, the same day (R. 58 and 61). The United States of America was made a party defendant because of a tax lien which it filed in the Erie County Clerk's Office January 15, 1953 (R. 66), subsequent to the date of the recording of plaintiff's mortgage (R. 61). The United States was made a party defendant to this foreclosure action pursuant to the provisions of Section 2410 (c) Title 28 U. S. C. (Appendix A). None of the local municipal taxing authorities is a party to the action (R. 3).

The first judgment of foreclosure and sale made by the Erie County Court June 3, 1959, foreclosed the tax lien of the United States from the mortgaged property, subject to the one year redemption period provided by 28 U. S. C. 2410 (c), and directed the referee appointed to conduct the foreclosure sale to sell the property subject to all unpaid real estate taxes and assessments pursuant to the provisions of Section 1087 of the New York Civil Practice Act (R. 50) (Appendix A). On appeal, the New York Supreme Court, Appellate Division, Fourth Department, on June 29, 1960, reversed this judgment and remanded this case to the Erie County Court (R. 46).

Subsequently, a resettled judgment of foreclosure and sale was made by the Erie County Court on October 20, 1960, which foreclosed the United States tax lien, subject to the one year redemption period provided for by 28 U. S. C. 2410 (c), and directed the referee appointed to conduct the foreclosure sale to pay the unpaid real estate taxes and assessments as expenses of the sale, pursuant to Section 1087 of the Civil Practice Act (R. 9). On appeal, the New York Supreme Court, Appellate Division, Fourth Department, by its order of May 9, 1961 (R. 108 to 114), reversed the second judgment of the Erie County Court, dated October 20, 1960 (R. 6 to 14), and directed that provisions should be inserted in the judgment providing that the referee to sell bring the entire proceeds of the sale into court, and for the court to then order a distribution of such proceeds in the manner directed in the cases, United States vs. City of New Britain, 347 U. S. 81, and Brown vs. General Laundry, 19 Conn. Supp. 335. On appeal, the Court of Appeals, State of New York, by its order of February 22, 1962, reversed the order of the Appellate Division, dated May 9, 1961, and reinstated the judgment of the Erie County Court dated October 20, 1960 (R. 6 to 14), which judgment provided for the payment of all real estate taxes and assessments as an expense of the sale before any moneys were allocated either to the plaintiff or the defendant United States of America (R. 9).

ARGUMENT

I

The New Britain case does not apply here.

The decision of the New York Court of Appeals in this matter is not in conflict with the United States vs. City of New Britain (347 U. S. 81, 98 L. Ed. 520) and the facts in this case are not four square with the facts in the New Britain case.

The mortgagee was not a party in the New Britain case. It therefore was not present and was not able to state the position that the effect of the decision was to give priority to the federal lien over the mortgage contrary to the provisions of 26 U. S. C. 3672 (Appendix A).

Furthermore, mortgage foreclosure procedure in Connecticut differs from that in New York in that in Connecticut the proceeds of a foreclosure sale are brought into Court and thereafter a supplemental judgment is rendered, specifying the parties who are entitled thereto and the amount to which each, including the plaintiff, is entitled (49 Conn. Gen. Statutes C846, Secs. 49-27, 49-29 (Appendix A), and Julia M. W. Gault vs. Jason Bacon, (142 Conn. 200), while in New York Section 1082 of the Civil Practice Act (Appendix A) provides on a default for a sale of the mortgaged premises to satisfy the mortgage debt, the expenses of sale, and the costs of the action, and all surplus moneys arising from the sale are then deposited in Court subject to further order, and Section 1087 of the New York Civil Practice Act (Appendix A), defines the payment of local taxes and assessments as an expense of the sale. Section 1082 of the New York Civil Practice Act is derived from Section 1626 of the

New York Code of Civil Procedure adopted by Chapter 522 of the Laws of New York of 1880 and Section 1087 is derived from Section 1676 of the Code of Civil Procedure adopted by Chapter 522 of the Laws of New York of 1880. Sections 1626 and 1676 of said Civil Code of Procedure, as adopted in 1880, are set forth in Appendix A.

As the New York Court of Appeals states, the local taxing authorities in this case are not competing with the United States for payment from the same fund. No question of "circular priority" arises. The local taxes will be paid as an expense of sale before the surplus from which the United States lien must be paid is created. The United States agreed to be bound by this procedure when, pursuant to 2410 (c) of the United States Code 28 (Appendix A), it submitted to the jurisdiction of the New York Courts. Section 1652 of Title 28 U. S. C. (Appendix A) makes this state law binding on the United States in a federal court. It certainly is equally binding on it in the state court.

II

The Brosnan case does apply.

All statements in the New Britain case to the effect that local taxes must come out of the mortgagee's share are *obiter dicta* and contrary to the later direct holding by this Court in U. S. v. Brosnan (363 U. S. 237, 4 L. Ed. 2d 1192), that local taxes can be paid in a foreclosure action as an expense of the sale.

New York and Connecticut foreclosure procedure, as respectively established by New York and Connecticut law, not only differ from each other but also differ from Penn-

sylvania foreclosure procedure, as described and approved of by this Court in United States vs. Brosnan, 363 U. S. 237. However, New York and Pennsylvania procedures have one thing in common, *i.e.*, the United States tax lien is foreclosed and divested from the mortgaged property without any payment on the federal lien, in a judicial foreclosure action, which also provides for the payment in full of local taxes and assessments as a part of the foreclosure action. This fact was brought to this Court's attention in the government's brief in the Brosnan case. This Court said in the Brosnan case, 363 U. S. 237, at page 242: "We believe that, so far as this Court is concerned, the need for uniformity (in the collection of federal taxes) in this instance is outweighed by the severe dislocation to local property relationships which would result from our disregarding state procedures." The application of the *dicta* in the New Britain case for which the government asks, would severely upset long established property rights in New York State and put New York mortgagees in a less advantageous position than their Pennsylvania counterparts.

III

The federal lien attached to the mortgaged property subject to the mortgagee's right to have local taxes and assessments paid out of the mortgaged property.

This Court has held that a federal tax lien can attach only to the mortgagor's property interest as determined by state law. Aquilino v. United States, 363 U. S. 509; United States v. Durham Lumber Co., 363 U. S. 522. By statute in New York, a mortgage is defined as a conveyance. Real Property Law 240 (2) and 290 (3) (Appendix A). When Joseph Victory, the mortgagor in this action,

executed his mortgage to Buffalo Savings Bank, he conveyed to Buffalo Savings Bank, as mortgagee, all those rights embraced within the mortgage contract as defined by New York Law (Sections 1082 and 1087 New York Civil Practice Act). He had conveyed to the mortgagee the right to have local taxes and assessments paid and satisfied out of the mortgaged premises. It was on this diminished ownership that the federal tax lien attached.

This right in the mortgagee to have real estate taxes and assessments paid out of the mortgaged premises is a right which Congress, when it enacted 2410 (c) of 28 U. S. C., must have known that mortgagees customarily and usually possessed, as those rights are discussed by Judge Haynsworth in his dissenting opinion in U. S. v. Bond, 279 F. 2d 837, 851, 852. Furthermore, the theory of "circular priority" as urged by the government in this case, causing the mortgagee to contribute toward the payment of a tax lien it does not owe, is directly contrary to the statement in the House Committee Report at the time of the adoption of 28 U. S. C. 2410 (c) (House of Representatives Report 95, 71st Congress, 2nd Session, page 1) (Appendix A) that it was adopted to correct the then existing situation where "He (the mortgagee) is, therefore, in effect defeated of his own right to foreclose unless he is willing to pay off the Government lien, a debt for which he is in no way responsible and he being a person to whom the Government would in no event look for its payment."

IV

The New York Court of Appeals decision is not in conflict with any federal court decisions.

The petition for certiorari states that the decision of the New York Court of Appeals conflicts with the decisions in the cases of U. S. vs. Bond, (Fourth Circuit) 279 F. (2) 837, U. S. vs. Christensen, (Ninth Circuit) 269 F. (2) 624, U. S. vs. Wasserman, (First Circuit) 257 F. (2) 491, Union Central Life vs. Peters, 361 Mich. 283, 105 N. W. (2d) 196, and First National Bank vs. Henneman Co., 10 Wisc. (2) 260, 103 N. W. (2) 24. The cases of U. S. vs. Bond, U. S. vs. Christensen and Union Central Life vs. Peters all involved advances made by a mortgagee to pay delinquent state taxes which were junior to a federal lien. When the mortgagee sought to claim a lien under his mortgage for such advances, it was held that the advances were junior to the federal tax lien. Such a situation is not presented in the present case. The mortgagee here has advanced no money for taxes. Furthermore the holdings are in conflict with the ruling of this Court in Security Mortgage Co. vs. Powers, 278 U. S. 149, 73 L. Ed. 236. Also the government has retreated from the position it took in these cases, on the requirement of choateness in a competing lien, by its concession in Crest Finance Co. vs. U. S., 368 U. S. 387, 7 L. Ed. 2d 342. The Wasserman case involved the construction of a provision of the federal bankruptcy act in a federal court and has no bearing on a case arising under state law. The case of First National Bank vs. Henneman Co. is similar to the New Britain case in that the county was a party, and the property was sold first leaving the proceeds in the custody of the court for further disposition under the competing tax liens. There is no provision in

the Wisconsin Statutes (1278 Section 10) (Appendix A) calling for the payment of taxes and the treatment thereof as expenses of sale. This case is not similar to the present case, except that it was a mortgage foreclosure action.

Conclusion

The decision below is correct. It is not in conflict with the decision in United States vs. New Britain (347 U. S. 81). It is in conformity with the decision in United States vs. Brosnan (363 U. S. 237). It does not impede the United States in any legitimate attempts to collect its tax liens. It is a statement by the highest New York Court of its interpretation of New York laws. It states New York practice. It defines New York property rights. It has no general application outside of New York State. It is not in conflict with any federal statute, or federal court decision.

It is therefore respectfully submitted that the petition for certiorari should be denied.

JOHN HORACE LITTLE,
Attorney for Buffalo Savings Bank.
545 Main Street,
Buffalo 3, New York.

May, 1962.

Appendix A

Sections 3670, 3671 and 3672 of Title 26 United States Code, 1952 Edition, are printed as Appendix "B" at pages 40 and 41 of the petition for writ of certiorari in this matter.

* * *

New York Civil Practice Act:

SEC. 1082. *Final judgment; surplus moneys.*

1. In an action to foreclose a mortgage upon real property, if the plaintiff becomes entitled to final judgment, it must direct the sale of the property mortgaged or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale and the costs of the action except as provided in subdivision two of this section. All surplus moneys arising from the sale of mortgaged premises under any judgment shall be deposited by the officer appointed to conduct the sale of the premises within five days after the same shall be received and be ascertainable to the credit of the action in a bank or trust company named by the court in the final judgment unless otherwise specially directed, subject to the further order of the court; and every judgment in foreclosure shall contain such directions, except where other provisions are made specially by the court. Any person claiming the surplus moneys arising upon the sale of mortgaged premises, or any part thereof, either in his own name or by his attorney at any time before the confirmation of the report of sale, may file with the clerk in whose office the report of sale is filed a written notice of such claim, stating therein the nature and extent of his claim and the address of himself or his attorney. A motion to confirm such report of sale shall not be made within three months after the filing of the report and shall in any event be made not later than four months after the filing of such report, except that if there be no surplus moneys arising from the sale of the mortgaged premises under such judgment,

any application for confirmation of the report of sale may be made at any time after the report shall have been filed eight days. Where the report of sale shows surplus money the party moving for confirmation of the report of sale shall present with his motion papers a proper voucher for the surplus moneys showing that they have been paid over, deposited or disposed of in pursuance of the judgment, a certificate of the clerk specifying the notices of claim to the surplus moneys, if any, so filed with him, and an affidavit showing any other unsatisfied lien on the property. Where it appears to the court, on such motion for confirmation of the report of sale, that the owner of the equity of redemption in the action is entitled to all of the surplus moneys, and is the only person claiming the same, it may order that such surplus moneys shall be paid over to such owner or his assigns by the officer appointed to conduct the sale of the premises, without further proceedings. Where it appears on such motion that the owner is not the only person claiming such surplus, the court shall direct the sheriff or referee making the sale, within five days after such order is made, to pay such surplus moneys in the city of New York to the treasurer of the said city, and in other counties outside of the city of New York, to the treasurer thereof, unless otherwise specially directed, subject to the further order of the court. In case of the death, disability, or removal of the officer appointed to conduct the sale of the premises, the court may grant an order authorizing the bank or trust company in which such surplus moneys are deposited to pay them over to the person or persons entitled thereto.

Sec. 1087. *Payment of taxes, assessments and water rates out of proceeds of sale.*

Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs

all taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. The provisions of this section shall not apply to any judgment in an action wherein any municipal corporation of this state is the plaintiff and the purchaser at the foreclosure sale thereunder.

* * *

Title 28 United States Code:

SEC. 1652. *State laws as rules of decision.*

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply. June 25, 1948, c. 646, 62 Stat. 944.

* * *

Title 28 United States Code:

SEC. 2410. *Actions affecting property on which United States has lien.*

(c) A judicial sale in such action or suit shall have the same effect respecting the discharge of the property from liens and encumbrances held by the United States as may be provided with respect to such matters by the local law of the place where the property is situated. A sale to satisfy a lien inferior to one of the United States, shall be made subject to and without disturbing the lien of the United States, unless the United States consents that the property may be sold free of its lien and the proceeds divided as the parties may be entitled. Where a sale of real estate is made

to satisfy a lien prior to that of the United States, the United States shall have one year from the date of sale within which to redeem. In any case where the debt owing the United States is due, the United States may ask, by way of affirmative relief, for the foreclosure of its own lien and where property is sold to satisfy a first lien held by the United States, the United States may bid at the sale such sum, not exceeding the amount of its claim with expenses of sale, as may be directed by the head of the department or agency of the United States which has charge of the administration of the laws in respect of which the claim of the United States arises.

* * *

New York Real Property Law:

SEC. 240. *Definitions and use of terms.*

2. The term "conveyance", as used in this article, includes every instrument, in writing, except a will, by which any estate or interest in real property is created, transferred, assigned or surrendered.

SEC. 290. *Definitions; effect of article.*

3. The term "conveyance" includes every written instrument, by which any estate or interest in real property is created, transferred, mortgaged or assigned, or by which the title of any real property may be affected, including any instrument in execution of a power, although the power be one of revocation only, and an instrument postponing or subordinating a mortgage lien; except a will, a lease for a term not exceeding three years, an executory contract for the sale or purchase of lands, and an instrument containing a power to convey real property as the agent or attorney for the owner of such property.

* * *

Appendix A

SECTION 1626 of the Code of Civil Procedure of the State of New York, predecessor to Section 1082 of the New York Civil Practice Act, as adopted by Chapter 178 of New York Laws of 1880:

> In an action to foreclose a mortgage upon real property, if the plaintiff become entitled to final judgment, it must direct the sale of the property mortgaged, or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale, and the costs of the action.

SECTION 1676 of the Code of Civil Procedure of the State of New York, predecessor to Section 1087 of the New York Civil Practice Act, as adopted by Chapter 178 of New York Laws of 1880:

> Where a judgment, rendered in an action for partition, for dower, or to foreclose a mortgage upon real property, directs a sale of the real property, the officer making the sale must, out of the proceeds, unless the judgment otherwise directs, pay all taxes, assessments, and water rates, which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments, or water rates, which have not apparently become absolute. The sums, necessary to make those payments and redemptions, are deemed expenses of the sale, within the meaning of that expression, as used in any provision of article second, third, or fourth of this title.
>
> * * *

General Statutes of Connecticut:

TITLE 49, CHAPTER 846.

SEC. 49-27. *Disposal of proceeds of sale.*

> The proceeds of each such sale shall be brought into court, there to be applied if the sale is ratified, in

accordance with the provisions of a supplemental judgment then to be rendered in such cause, specifying the parties who are entitled to the same and the amount to which each is entitled; and, if any part of the debt or obligation secured by the mortgage or lien foreclosed or by any subsequent mortgage or lien was not payable at the date of the judgment of foreclosure, it shall nevertheless be paid as far as may be out of such proceeds as if due and payable, with rebate of interest where such debt was payable without interest, provided, if the plaintiff is the purchaser at any such sale, he shall be required to bring into court only so much of such proceeds as exceed the amount due upon his judgment debt, interest and costs. (1949 Rev., S. 7208.)

SEC. 49-29. *Expenses of sale and costs.*

The court shall order the judgment and costs of the plaintiff to be first paid out of the proceeds of such sale and shall allow, to such of the parties as receive the balance of such proceeds, the costs usually allowed to successful parties, which costs shall be paid in addition to their respective claims and in the same order. (1949 Rev., S. 7210.)

* * *

Wisconsin Statutes:

CHAPTER 287.10. *Foreclosure.*

(1) If the plaintiff recovers the judgment shall describe the mortgaged premises and fix the amount of the mortgage debt then due and also the amount of each instalment thereafter to become due, and the time when it will become due, and whether the mortgaged premises can be sold in parcels and whether any part thereof is a homestead, and shall adjudge that the mortgaged premises be sold for the payment of the amount then due and of all instalments which shall become due before the sale, or so much thereof as may be sold separately without material injury to

the parties interested, and be sufficient to pay such principal, interest and costs; and when demanded in the complaint, direct that judgment shall be rendered for any deficiency against the parties personally liable and, if the sale is to be by referee, he must be named therein.

(2) Any party may become a purchaser. But no such sale shall be made or advertised until the expiration of one year from the date when such judgment is entered; and when judgment is for instalments due and to become due, and payment shall be made within the year, of the instalments found due at the date of the judgment, with interest and costs, no sale shall be made or advertised upon any instalment growing due after the date of the judgment until one year after the same shall become due; but in all cases the parties may, by stipulation, filed with the clerk, consent to an earlier sale. Sales under foreclosure of mortgages given by any railroad corporation may be made immediately after the rendition of the judgment.

(3) The proceeds of every sale shall be applied to the discharge of the debt adjudged to be due and the costs awarded; and if there shall be any surplus it shall be subject to the order of the court. If any surplus remains in the court for three months, without being applied for, the court shall direct the same to be put out at interest for the benefit of the party entitled thereto to be paid to him upon the order of such court.

(4) The court may order in the judgment of foreclosure that all sums advanced by the plaintiff for insurance, necessary repairs and taxes not included in the judgment may be added to the judgment by order at any time after the entry thereof.

* * *

Appendix A

House of Representatives Report 95, 71st Congress, 2nd Session:

TO PERMIT THE UNITED STATES TO BE MADE A PARTY DEFENDANT IN CERTAIN CASES.

December 21, 1929 Referred to the House Calendar and ordered to be printed

Mr. Graham, from the Committee on the Judiciary, submitted the following

REPORT

(To accompany H. R. 980)

The Committee on the Judiciary, to whom was referred the bill H. R. 980, after consideration reports the same favorably and recommends that the bill do pass.

This bill is identical with the bill H. R. 13981, which was favorably reported by this committee in the Seventieth Congress and passed the House by unanimous consent.

This legislation has been recommended for a number of years by the American Bar Association through its committee on removal of Government liens on real estate, the United States League of Local Building and Loan Associations, and by numerous land title companies, in order to relieve against the injustice with which mortgagees are confronted under the present state of the law who find, when it is necessary to foreclose their mortgages, that there has been filed against the property a junior lien by the Federal Government for some debt due the United States by the owner of the equity in the property, and for which the mortgagee owes no obligation either legal or moral. In such circumstances the mortgagee find himself at an impasse. It is impossible for him to bring about a judicial sale of the property owing to the cloud upon the title created by the Government's lien. He cannot remove the lien as there is no method by which he

may bring the United States in as one of the parties to the foreclosure proceeding. He is, therefore, in effect defeated of his own right to foreclose unless he is willing to pay off the Government lien, a debt for which he is in no way responsible and he being a person to whom the Government would in no event look for its payment.

The purpose of this bill is to provide a simple and just method of proceeding in such cases, one which is fair to the holder of the prior lien on the real estate and which amply and fully protects the rights of the Federal Government.

INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statutes involved	2
Statement	2
Summary of argument	5
Argument:	
Federal law gives the federal tax lien priority over subsequently accrued liens for city and county taxes and state law cannot reverse the order of payment by "deeming" the local liens "expenses of the [foreclosure] sale"	9
A. The *New Britain* case is controlling and requires that the federal tax lien be given priority over the subsequently accrued local tax liens	10
B. The grounds on which the court below attempted to distinguish and limit *New Britain* are untenable	13
1. The liens competing here are of equal dignity and the federal lien takes priority over the later local tax liens	13
2. A state may not supersede federal rules of priority and obtain prior payment of subsequently-accrued local liens by deeming them "expenses of the [foreclosure] sale"	18
3. *United States* v. *Brosnan*, 363 U.S. 237, does not call for the application of the New York statutory provisions which treat the payment of liens for local taxes as an expense of a mortgage foreclosure sale, so as to defeat the priority of the federal lien	22

658512—62——1

Argument—Continued
Federal law—Continued
B. The grounds—Continued
4. The rules of priority established by *New Britain* do not give way where state law creates a "circular priority" of liens ..... Page 25
C. Other courts have consistently rejected the grounds on which the majority below attempted to distinguish *New Britain* and have held the federal tax lien entitled to priority in cases indistinguishable from this 28
Conclusion 31
Appendix 33

CITATIONS

Cases:

American Surety Co. v. *Sundberg*, 58 Wash. 2d 337, 363 P. 2d 99, certiorari denied, 368 U.S. 989 28
Aquilino v. *United States*, 363 U.S. 509 ..... 7, 13, 15, 16
Brown v. *General Laundry Service, Inc.*, 19 Conn. Sup. 335, 119 A. 2d 601 ..... 19, 20
Brown v. *General Laundry Service, Inc.*, 139 Conn. 363, 94 A. 2d 10 26
Buffalo Savings Bk. v. *Victory*, 13 App. Div. 2d 207, 215 N.Y.S. 2d 189 19
Co-operative Loan and Sav. Soc. v. *McDermott*, 14 App. Div. 2d 590, 218 N.Y.S. 2d 268 19
Crest Finance Co. v. *United States*, 368 U.S. 347 10
Dunkirk Trust Co. v. *Dunkirk Laundry Co.*, 17 Misc. 2d 298, 182 N.Y.S. 2d 381 19
Feinstein v. *Earl*, 228 N.Y.S. 2d 643 30
First Fed. Sav. & Loan Ass'n v. *Lewis*, 14 Div. App. 2d 150, 218 N.Y.S. 2d 857 19
First Federal Sav. & Loan Ass'n of Port Jervis v. *Levy*, 31 Misc. 2d 459, 222 N.Y.S. 2d 908 19
First Nat. Bank of Chippewa Falls v. *Henneman Co.*, 10 Wis. 2d 260, 103 N.W. 2d 24, certiorari denied, 364 U.S. 836 28
Kronenberg v. *Ellenville Nurseries & Greenhouses*, 22 Misc. 2d 247, 196 N.Y.S. 2d 106 19

Cases—Continued

	Page
Metropolitan Life Ins. Co. v. *United States*, 9 N.Y. App. 2d 356, 194 N.Y.S. 2d 168	19
Michigan v. *United States*, 317 U.S. 338	7, 15, 16, 18
Rikoon v. *Two Boro Dress, Inc.*, 9 Misc. 2d 591, 171 N.Y.S. 2d 19, modified, 8 App. Div. 2d 986, 190 N.Y.S. 2d 790, appeal dismissed, App. Div. 2d 783, 193 N.Y.S. 2d 302	19
Samms v. *Chicago Title & Trust Co.*, 349 Ill. App. 413, 111 N.E. 2d 172	29
Southern Ohio Savings Bank & Trust Co. v. *Bolce*, 165 Ohio St. 201, 135 N.E. 2d 382	28
Stadelman v. *Hornell Woodworking Corp.*, 172 F. Supp. 156	19
Trimm v. *Marsh*, 54 N.Y. 599	17
Union Central Life Ins. Co. v. *Peters*, 361 Mich. 283, 105 N.W. 2d 196, reversed *sub. nom. United States* v. *Union Central Life Ins Co.*, 368 U.S. 291	24, 28
United States v. *Acri*, 348 U.S. 211	10
United States v. *Ball Construction Co.*, 355 U.S. 587	10, 12
United States v. *Bond*, 279 F. 2d 837, certiorari denied, 364 U.S. 895	28, 30
United States v. *Brosnan*, 264 F. 2d 762	22
United States v. *Brosnan*, 363 U.S. 237	8, 10, 17, 18, 20, 22, 23
United States v. *Christensen*, 269 F. 2d 624	29, 30
United States v. *City of Greenville*, 118 F. 2d 963	16
United States v. *Colotta*, 350 U.S. 808	10
United States v. *Costas*, 142 So. 2d 699	29
United States v. *Hulley*, 358 U.S. 66	10
United States v. *John Hancock Mut. Ins. Co.*, 364 U.S. 301	18
United States v. *Liverpool & London Ins. Co.*, 348 U.S. 215	10
United States v. *New Britain*, 347 U.S. 81	5, 6, 8, 9, 10, 12, 13, 14, 15, 16, 19, 20, 22, 23, 24, 25, 26, 28, 30, 31.
United States v. *Scovil*, 348 U.S. 218	10
United States v. *Security Tr. & Sav. Bk.*, 340 U.S. 47	12

Cases—Continued Page
United States v. *Vorreiter*, 355 U.S. 15 10
United States v. *Wasserman*, 257 F. 2d 491 28
United States v. *White Bear Brewing Co.*, 350 U.S. 1010 .. 10
Wesselman v. *Engel Co.*, 309 N.Y. 27, 127 N.E. 2d 736 .. 20, 24
Statutes:
Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):
Sec. 3670 ..... 5, 9, 10, 17, 23, 33
Sec. 3671 ..... 5, 17, 33
Sec. 3672(a) 5, 26, 30
Internal Revenue Code of 1954 (26 U.S.C., 1958 ed.):
Sec. 6323(f) 29
28 U.S.C.:
Section 2410 18
Section 2410(c) 18
6A Gilbert-Bliss Civil Practice of New York, Annotated (Recompiled 1944):
Sec. 1082 ..... 24, 34
Sec. 1083 ..... 24, 34
Sec. 1087 ..... 4, 6, 18, 35
McKinney's Consolidated Laws of New York, Annotated:
New York Lien Law, Sec. 240(1) (1962 Cum. Supp.) 35
New York Public Authorities Law, Sec. 1180 35
New York Tax Law (Vol. 49, Part II) Secs. 554, 555 20
New York Real Property Tax Law, Sec. 902 (Historical Note) 36
Erie County Tax Act, Sec. 6-2.0, Laws of 1942, c. 812 .. 36
City of Buffalo Charter (1950):
Sec. 534 36
Sec. 590 36
Miscellaneous:
Seligson, *Creditors Rights, 1961 Annual Survey of American L.* 13, 24
Wiltzie, *Mortgage Foreclosure* (5th ed., 1939):
Vol. 2, Sec. 929 *et seq* 20
Vol. 3, Sec. 1007 20

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 96

UNITED STATES, PETITIONER

v.

BUFFALO SAVINGS BANK

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The first opinion of the Erie County Court (R. 37–42), is reported at 186 N.Y.S. 2d 960, 17 Misc. 2d 564. The opinion of the Appellate Division (R. 19–22), is reported at 202 N.Y.S. 2d 70, 11 App. Div. 2d 158. The opinion of the Erie County Court on remand (R. 12–19), is reported at 206 N.Y.S. 2d 518, 26 Misc. 2d 443. The opinion of the Appellate Division on the second appeal (R. 64–68) is reported at 215 N.Y.S. 2d 189, 13 App. Div. 2d 207. The opinion of the New York Court of Appeals (R. 74–91), is reported at 11 N.Y. 2d 31, 226 N.Y.S. 2d 382.

JURISDICTION

The judgment of the Court of Appeals of the State of New York was entered on February 22, 1962 (R. 91–92). The petition for a writ of certiorari was filed on April 30, 1962, and was granted on June 11, 1962 (R. 93; 370 U.S. 915). The jurisdiction of this Court rests on 28 U.S.C. 1257(3).

QUESTION PRESENTED

Whether the priority of payment accorded an earlier-arising federal tax lien by *United States* v. *New Britain*, 347 U.S. 81, may be defeated by a provision of State law that payments to discharge local tax liens shall be "deemed" expenses of a mortgage foreclosure sale.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1939, the statutes of the State of New York, the Tax Act of Erie County, and the City of Buffalo Charter, are set forth in the appendix, *infra*, pp. 33–37.

STATEMENT

This is a mortgage foreclosure case which involves the relative priority of a federal tax lien and local (city and county) liens on the proceeds of the foreclosure sale of the property to which the liens had attached.

On April 5, 1946, respondent Buffalo Savings Bank (the mortgagee-bank) lent $2,600 to Joseph B. Victory (the taxpayer-mortgagor), receiving a mortgage on real property to secure its loan. The mortgage was recorded on the same day (R. 31–32, 74). On January 15, 1953, the United States filed in the Erie County

Clerk's office a notice of a federal tax lien for $857.07, against the mortgagor (R. 36, 50, 74).[1] On and after July 1, 1957, local liens attached to the mortgaged property resulting from defaults in the payment of real estate taxes for 1957 and 1958 owed to the City of Buffalo, real estate taxes for 1958 owed to Erie County, and sewer rents levied by the Buffalo Sewer Authority (R. 34, 74).[2]

The present action for foreclosure of its mortgage was begun in the Erie County Court on October 21, 1958, by the bank (R. 42, 49). At that time, there was a balance due on the mortgage of $1,473.75, plus interest at the rate of 5 percent per annum, from January 10, 1958 (R. 35). The record does not show the amounts due on account of the local taxes and assessments. Nor does it indicate that the mortgagor was insolvent (R. 86).

The Erie County Court entered a judgment, pursuant to the mortgagee-bank's motion for summary judgment, providing that the mortgaged property should be sold "subject to all taxes, assessments and water rates, which are or may become liens on the premises at the time of the sale," but free and clear of the federal tax lien, and that after payment of the expenses of the foreclosure, the proceeds be used first to satisfy the mortgage debt (R. 29, 36–38).[3] Upon

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[1] Of this amount, a balance of $689.07, plus interest, remained unpaid on January 5, 1959, when the United States filed an answer to the complaint herein (R. 50–51).

[2] The mortgagee-bank did not advance any sums for payment of these local real property taxes and assessments (R. 36, 74).

[3] The County Court's opinion (R. 37–42), entered May 29, 1959, is reported at 186 N.Y.S. 2d 960, 17 Misc. 2d 564.

appeal by the United States, the Appellate Division reversed the judgment,[4] stating (R. 20) that a sale free and clear of the federal tax lien but subject to local liens would erroneously give the local liens "a super-priority," in disregard of the fact that they are inferior to the earlier-arising federal tax lien. The court suggested that the local taxing authorities be made parties to the action and that the property be sold free and clear of all liens, leaving the question of priorities to be decided at a later date (R. 22).

Upon remand, the County Court amended its judgment to order a sale free of all liens, the proceeds of which were to be used first to pay all local real estate taxes, assessments and water rates "as a part of the expenses of the sale," pursuant to Section 1087 of the New York Civil Practice Act (R. 3–5).[5] The Appellate Division modified the judgment (R. 60–64) to apply to the proceeds of the foreclosure sale "the rule of priorities laid down in *United States* v. *City of New Britain*, 347 U.S. 81" (R. 65) under which the liens for local taxes, assessments and water rates are "inferior to the tax lien of the United States, having accrued subsequent to the time of the filing of the United States tax lien" (R. 67, R. 68–73).[6]

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[4] Its *per curiam* opinion (R. 19–22) is reported at 202 N.Y.S. 2d 70, 11 App. Div. 2d 158.

[5] Its opinion (R. 12–19), dated October 18, 1960, is reported at 206 N.Y.S. 2d 518, 26 Misc. 2d 443.

[6] The court's opinion (R. 64–68) is reported at 215 N.Y.S. 2d 189, 13 App. Div. 2d 207.

"The Appellate Division directed that the property be sold free and clear of all liens; that the proceeds be deposited in a bank; that from such proceeds the referee pay the fees, costs

On appeal by respondent, a majority of the New York Court of Appeals (R. 74–83), although approving the order directing a sale of the property free and clear of all liens, reversed the Appellate Division's decision as to the distribution of the proceeds and reinstated the County Court judgment of foreclosure which authorized the payment of later-arising local taxes ahead of prior federal taxes, as expenses of the foreclosure sale (R. 3–5, 26, 36). Judge Fuld (with whom Judge Foster concurred), dissenting (R. 83–90), stated (R. 89) that "[i]t comports neither with reality nor with law to give such 'potential liens priority over the pre-existing matured Federal lien by labeling them 'expenses of the sale' in foreclosure proceedings."

SUMMARY OF ARGUMENT

In *United States* v. *New Britain*, 347 U.S. 81, this Court announced three controlling principles with respect to federal lien law applicable under Sections 3670–3672 of the Internal Revenue Code of 1939: (1) that a local real estate tax lien cannot compete with a federal tax lien until it becomes choate by attachment to specific pieces of real property; (2) that as be-

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and disbursements allowed; that out of the net proceeds then remaining, the referee set aside, in a separate bank account in his name, designated as 'Priority Adjustment Fund,' the sum due upon the mortgage and also a sum sufficient to pay other outstanding liens, if any, superior to the tax lien of the United States; that from the balance, if any, remaining, the referee pay first the tax lien of the United States, and then the local real estate taxes, assessments and water rates; that if there were insufficient moneys available to pay such real estate taxes, assessments and water rates, the balance thereof was to be paid out of the Priority Adjustment Fund" (R. 61–62).

658512—62——2

tween the federal tax lien and choate or perfected local real estate tax liens, absent insolvency, priority is determined by the rule of first in time, first in right, so that a federal tax lien is superior to a later-arising local real estate tax lien; and (3) that the priority of a federal tax lien under federal law cannot be impaired or affected by state rules of priority which accord local real estate tax liens priority over any mortgage. *New Britain* has thus provided the basic rule of decision with respect to the definition of choate liens, the priority of liens and the supremacy of the federal lien law. The decision has been steadily followed, not only in the general field of federal tax lien law, but also by three courts of appeals and two State Supreme Courts in the specific situation—present here—of a foreclosure of a senior mortgage which under state law is subordinated to local real estate tax liens.

Although the facts of the instant case are "on all fours" with those of *United States* v. *New Britain*, the New York Court of Appeals (two judges dissenting) has failed to follow that decision. It has held that local real estate taxes which accrued subsequent to the filing of notice of a federal tax lien are entitled to payment ahead of the federal tax lien out of the proceeds of sale of the mortgaged property as a part of the "expenses of the sale," as provided by Section 1087 of the New York Civil Practice Act. The ruling accords such taxes a "super-priority" directly contrary to every principle of *New Britain*.

The correctness of *New Britain* and the error of the majority decision below are demonstrated by the

fallacious propositions upon which the latter must rely. The prime fallacy is the assertion that the lien for local real estate taxes is by nature paramount to the federal tax lien, so that the *New Britain* rule of first in time, first in right, is rendered wholly inapplicable. In an effort to gain support from the principle of *Aquilino* v. *United States,* 363 U.S. 509, that state law defines the property rights subject to the federal tax lien, the majority attempts to cloak this assertion as a statement of the rights of a taxpayer in real property under New York law. The theory is that an owner's interests are conditioned upon the payment of local taxes, and the United States as a creditor of the taxpayer is subject to the same overriding limitation. It is manifest, however, even from the majority opinion itself that this supposed limitation on the taxpayer's interest does not stem from any lack of ownership rights, but rather is derived from the assertedly superior nature of the State tax lien. The majority recognizes that the taxpayer possesses a fee. Its position is that the State tax liens attach directly to this property while the federal tax lien attaches only to the taxpayer's interest in the property. But this distinction is directly contrary to the settled decisions of this Court. The law established by this Court holds that the federal tax lien attaches to the property itself, exactly as a state tax lien (*e.g., Michigan* v. *United States,* 317 U.S. 338) and takes priority over all subsequently attaching liens.

In any event, a state court may not confine the federal tax lien to special property rights determined only for purposes of the federal tax lien. For all other purposes New York property law treats a tax-

payer as the owner of the property as against both the mortgagee and the State, neither of which has more than a lien interest in the property. The federal tax lien therefore attached to the general ownership rights of the taxpayer, and once attached, could not be displaced by subsequent local tax liens.

Once the basic propositions involved in this case are stated, the remaining issues are speedily resolved. The State cannot impair the federal statutory lien by deeming subsequently-accrued local tax liens "expenses of the foreclosure sale." Such state provisions to assure the payment of state taxes cannot convert them into prior liens as against the earlier-assessed and perfected federal tax liens. Nor is there anything in *United States* v. *Brosnan*, 363 U.S. 237, which qualifies the priority of federal tax liens over later-arising state tax liens. On the contrary, in holding that state procedures for the extinguishing of liens junior to a mortgage were applicable to junior federal tax liens, this Court expressly reaffirmed the order of priority in time established by *New Britain*.

Faced with the problem of circular priorities which *New Britain* resolved by maintaining the underlying priority of the federal tax lien, the majority below has here resolved the problem by eliminating it. In its view, there is no circular priority, because the federal tax lien has no competing priority at all; it is always subordinate to an earlier mortgage and to later state taxes. But this resolution subverts basic principles of federal tax lien law.

The *New Britain* decision has been consistently followed by other courts, which have rejected the dis-

tinctions attempted by the court below. The priority of the federal tax lien was established by this Court on the ground that Congress, in order to protect federal revenues, provided for such a lien. There is no showing here that the federal lien so established has overburdened either municipalities or mortgagees. By contrast, the decision below would impose upon the federal government the impossible burden of seeking immediate foreclosure of its tax liens in order to protect itself against later-arising local real estate taxes.

ARGUMENT

FEDERAL LAW GIVES THE FEDERAL TAX LIEN PRIORITY OVER SUBSEQUENTLY ACCRUED LIENS FOR CITY AND COUNTY TAXES AND STATE LAW CANNOT REVERSE THE ORDER OF PAYMENT BY "DEEMING" THE LOCAL LIENS "EXPENSES OF THE [FORECLOSURE] SALE"

In *United States* v. *New Britain*, 347 U.S. 81, this Court struck down a State's direct attempt by statute to grant local real estate tax liens priority over "all other liens or encumbrances" (*id.* at 83) including previously filed federal tax liens. The Court held that "the State cannot on behalf of the City impair the standing of the federal liens, without the consent of Congress" (*id.* at 84) and that Congress, when it enacted Section 3670 of the Internal Revenue Code of 1939 (which created the federal tax lien), had incorporated therein as a federal rule of priority the principle of law that "the first in time is the first in right" (*id.* at 85–86). The question in this case is whether a State may achieve by indirection what it may not do directly, that is, may a State afford sub-

sequently-accruing local tax liens first priority by means of a statute which directs that such liens shall be "deemed" expenses of the foreclosure sale and paid out of the proceeds in advance of all other liens. We think it clear that the *New Britain* decision cannot be so easily defeated.

A. THE *NEW BRITAIN* CASE IS CONTROLLING AND REQUIRES THAT THE FEDERAL TAX LIEN BE GIVEN PRIORITY OVER THE SUBSEQUENTLY ACCRUED LOCAL TAX LIENS

The relevant facts of the *New Britain* case were these: A foreclosure sale of the taxpayer's real property produced a fund of $28,071 against which were claims of $31,000 including the expenses of the sale, two mortgages, a recorded judgment, city real-estate-tax liens and water-rent liens, and federal tax liens. The state courts held that the city liens were entitled to payment prior to all other claims except those for expenses of sale, regardless of the date on which they became perfected and attached to the taxpayer's property. This Court reversed and held, in an opinion which has furnished the foundation for a long line of later decisions,[7] that, although Congress did not set forth a schedule of priorities in Section 3670, it implicitly incorporated the familiar rule of "first in time, first in right" (*id.* at 87), which makes the

[7] *United States* v. *Acri*, 348 U.S. 211; *United States* v. *Liverpool & London Ins. Co.*, 348 U.S. 215; *United States* v. *Scovil*, 348 U.S. 218; *United States* v. *Colotta*, 350 U.S. 808; *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010; *United States* v. *Vorreiter*, 355 U.S. 15; *United States* v. *Ball Construction Co.*, 355 U.S. 587; *United States* v. *Hulley*, 358 U.S. 66. See also *Crest Finance Co.* v. *United States*, 368 U.S. 347, and *United States* v. *Brosnan*, 363 U.S. 237, 240.

priorities of competing local real estate and federal tax liens "depend on the time [each] attached to the property in question and became choate" (*id.* at 86). The local assessed real estate tax lien did not become choate until it attached to specific property, at which point it received equal status with the federal tax lien arising upon assessment. Accordingly, the Court held, any federal tax liens which attached to the taxpayer's property at an earlier date than the local liens for real estate taxes and water rents were entitled to a prior right to the proceeds of sale of the property.

The Court specifically rejected the contention that Congress did not intend the rule of "first in time, first in right" to supersede state laws of priority at least to the extent that they made certain interests superior to mortgages. It made no difference, the Court said, that because of state laws payment of the federal tax lien might come at the expense of the mortgagee whose lien was recorded first and was therefore first in priority under federal law. This "circular priority" could not change the Court's finding that Congress intended to adopt a single rule for determining the priority of federal tax liens. Thus, it declared (*id.* at 88):

> * * * The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage * * * Congress intended to assert the federal lien. * * *

Since the significant facts in the present case are indistinguishable from those in *New Britain*, that decision requires the federal lien to be given priority over the subsequent state liens. Here the federal lien was perfected on January 15, 1953, when the notice of lien was filed in the County Clerk's Office (see *supra*, pp. 2–3). The state liens did not come into existence until more than four years later (in 1957 and 1958) (*ibid.*). The federal lien was thus unquestionably the "first in time," and under *New Britain* it was therefore the "first in right."

The New York Court of Appeals, refusing to follow *New Britain*, held (R. 74) that "the Federal tax lien is not entitled to priority over subsequently accrued local tax liens—superior to the mortgage debt—since the respective liens are not comparable charges on real property and the 'mortgagee' has an absolute preference over Federal liens."

This conclusion involves the rejection of the findings and principles on which *New Britain* stands. It discards the rule of "'first in time, first in right,'" and, by treating the liens for local taxes as if they attached on the date of the mortgage, adopts a position analogous to the doctrine of relation-back to defeat the priority of the federal tax lien. This reasoning is contrary to the rule of *United States* v. *Security Tr. & Sav. Bk.*, 340 U.S. 47, 50, and numerous subsequent decisions of this Court that the doctrine of relation back cannot "operate to destroy the realities of the situation."* The decision below rejects the choate or perfected lien test which has been applied by this Court in cases of this kind, without exception, and it rejects the su-

* See *United States* v. *Ball Construction Co.*, 355 U.S. 587.

premacy of federal law which this Court has held to be controlling in matters involving the relative priority of federal liens (*Aquilino v. United States*, 363 U.S. 509, 513–514).* Finally, and in direct conflict with the square holding in *New Britain* (347 U.S. at 88), the majority finds that Congress, in creating the federal tax lien and establishing its priority, did not intend to "curtail the absolute preference granted to mortgagees" (R. 77). In support or explanation of these conflicts, the majority attempts to distinguish *New Britain*, but, as stated by Judges Fuld and Foster in dissent (R. 83–90) and as will be shown below, none of the distinctions is tenable. In sum, the decision of the majority would negate the large body of federal lien law already established by this Court.

B. THE GROUNDS ON WHICH THE COURT BELOW ATTEMPTED TO DISTINGUISH AND LIMIT *NEW BRITAIN* ARE UNTENABLE

1. The liens competing here are of equal dignity and the federal lien takes priority over the later local tax liens

The local tax liens involved in *New Britain* were exactly the same as those involved in this case, namely, municipal liens for real property taxes and water rates owed by the taxpayer mortgagor. The foundation of the *New Britain* ruling is the Court's holding (347 U.S. at 84) that—

> the general statutory liens of the United States are as binding as the specific statutory liens of the City. The City gains no priority by the

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*The decision below is severely criticized on these and other grounds by Professor Charles Seligson in "*Creditors' Rights*," *1961 Annual Survey of American Law*, 273, 278–279, 281.

> fact that its liens are specific while the United States' liens are general. Obviously, the State cannot on behalf of the City impair the standing of the federal liens, without the consent of Congress. * * *

The majority below attempted to distinguish *New Britain* upon the ground that the liens are not comparable. Thus, the majority says (R. 78) that the claim of the United States—

> depends on the obviously fallacious contention that the lien of the municipality upon the land is akin to the lien of the Federal Government as a creditor of the mortgagor. The plain answer is that the Federal Government is only the creditor of a debtor whose interest in the land is subordinate to the local government lien * * *. As a lien for taxes for essential services supplied for the benefit of the land, it attached directly to the particular parcel of real property. The Federal lien was filed in the Clerk's office against a presumed equity in the real property held by the mortgagor. * * *

This ruling that the two liens are not akin and that the local liens are by nature superior because they attach to the specific property is the core of the majority's position. However, in comparing the two liens and holding them disparate, the majority, despite its disclaimer, has necessarily determined the nature of the federal tax lien. This, however, is a matter of federal, not state, law. Moreover, the majority's determination of the nature of the federal tax lien is directly contrary to the holdings of this Court that, as a matter of federal law, the federal tax lien attaches

to the same property to which the state-created liens attach. *Michigan* v. *United States*, 317 U.S. 338; *United States* v. *New Britain*, *supra*, and cases cited, note 7, *supra*.

Recognizing the force of these holdings, the majority has expressly disclaimed any attempt to pass upon the nature of the federal tax lien. Thus, it stated (R. 76):

> Our State law has not characterized the nature and extent of the Federal tax lien, but has determined the nature and extent of the property interests of the taxpayer (admittedly a State function), which in the case of real property is conditioned upon the payment of annually recurring governmental land taxes, the payment of which may not be avoided by a foreclosure sale; * * *

The court is attempting to rely on *Aquilino* v. *United States*, *supra*, where this Court held that federal and state courts are to look to state law to determine the property rights to which the federal tax lien attaches. This reliance is misplaced.

The court is not here giving effect to a state definition of property interests. It is clear from the court's statement—"the property interests of the taxpayer * * * in the case of real property is conditioned upon the payment of annually recurring governmental land taxes"—that under New York law the taxpayer does own a fee even though his interest may be diminished for failure to pay subsequently accruing local taxes.[10]

[10] In this connection it is noted that the New York statutes merely impose liens upon the property for the non-payment of real estate taxes and water rents. They do not purport to define or limit the owner's interest. See Appendix, *infra*, pp. 35–36.

Thus, the majority is not giving effect to a state definition of property which precludes attachment of the federal lien, but is merely asserting the paramount nature of the local tax lien under local law. Since the taxpayer owns the fee, then under *Aquilino* the federal tax lien attaches to that fee and enjoys priority over all later accruing liens."

For all purposes other than determining the relative priority of the federal tax lien and local liens, the State of New York treats the mortgagor as the owner of the property, and not merely as the holder of whatever equity may remain after prior claims against the property have been satisfied. The New York law of real property, like that of Connecticut, is that a mortgage is merely security for a debt, and gives the mortgagee no title or estate whatever. Both in law and equity, the mortgagor is regarded as the owner of the fee. His interest in the real estate can be sold upon execution; his widow is entitled to dower; he can convey and devise his interest as real estate; at his death, it descends to his heirs; he has every attribute and right of an absolute owner of the real estate, subject to the lien of the mortgage, and his title can be de-

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"It is a misapplication of *New Britain* and *Michigan* to hold, as the majority below does, that the federal tax lien is subordinate to the lien of subsequently accruing city taxes, because the interests of a mortgagor-taxpayer are subordinate thereto. As Judge Parker stated in *United States* v. *City of Greenville*, 118 F. 2d 963, 966 (C.A. 4), (cited with approval in *Michigan*):

"The difference is that the rights of the mortgagee as well as of the mortgagor in the mortgaged property are held subject to the power of the state to tax it, whereas the rights of the federal government are not held subject to that power."

feated only by foreclosure; he remains the true owner and may maintain trespass even against the mortgagee. While in relation to the mortgagee, his estate is usually called an equity of redemption, "as to all the world he is the owner." *Trimm* v. *Marsh*, 54 N.Y. 599, 603–604, 608.

This ownership interest was the property which the taxpayer held on the date the federal tax was assessed, and on the date (January 15, 1953) when notice of that lien was filed. The fact that the taxpayer-mortgagor's interest in the property was subject to being terminated under a state mortgage-foreclosure proceeding neither limited his interest nor diminished the "property" to which the federal lien attached, for "the mortgagors owned the entire fee interests in the properties, subject only to the mortgages." *United States* v. *Brosnan*, 363 U.S. 237, 241. As pointed out in that case (p. 241):

> This Court has repeatedly rejected the contention that because a fee owned by a taxpayer was already encumbered by a lien which enjoyed seniority under state law, the Government's lien necessarily attached subject to that lien. *A fortiori*, the "property" to which the federal lien can attach is not diminished by the particular means of enforcement possessed by a competing lienor to whom federal law concedes priority.

It is clear, then, that under the provisions of Sections 3670 and 3671, the federal tax liens here involved arose and attached to all of taxpayer's property, including the real property here in issue. While this occurred *after* the real property had been mort-

gaged to Buffalo Savings Bank, it was *before* any of the state tax liens now asserted had arisen. Thus, the federal lien attached to the real estate subject only to the payment of the prior mortgage indebtedness with interest thereon. New York law could not prevent the federal lien from attaching to the real estate. Nor could the particular means of enforcement which State law afforded to a competing lienor diminish the property to which the federal lien attached. *United States* v. *Brosnan*, *supra*, 363 U.S. at 241. This is in conformity with the fundamental principle that provisions of state law which are inconsistent with federal statutes "must fall under the Supremacy Clause of the United States Constitution." *United States* v. *John Hancock Mut. Ins. Co.*, 364 U.S. 301, 305;[12] *Michigan* v. *United States*, 317 U.S. 338, 340.

2. A state may not supersede federal rules of priority and obtain prior payment of subsequently accrued local liens by deeming them "expenses of the [foreclosure] sale"

The majority of the court below relied (R. 79) upon the fact that under New York State law (Section 1087) (Appendix, *infra*, p. 35) payment of local taxes, assessments and water rates which have become "liens" upon the property, sold pursuant to a judgment rendered in a mortgage foreclosure action, "are deemed expenses of the sale within the meaning of that expression as used in any provision of this article." Accordingly,

[12] There, this Court held that the United States as a junior lienor of real estate judicially foreclosed in a proceeding to which the United States was made a party under 28 U.S.C. 2410, could redeem within one year from the date of sale pursuant to 28 U.S.C. 2410(c), despite a conflicting state statute giving the mortgagors the exclusive right to redeem within that period.

it concluded that "the proper procedure of this State" required the referee to pay the real estate taxes, assessments and water rates out of the proceeds of the sale "as expenses of the sale" (R. 83). This same argument was considered and rejected on the authority of *New Britain*, by the United States District Court for the Western District of New York,[13] and by two Appellate Divisions of the Supreme Court of the State of New York,[14] as well as by the Appellate Division in the instant case.

The majority found support for its position in the decision of the Supreme Court of Connecticut (*Brown v. General Laundry Service, Inc.*, 19 Conn. Sup. 335, 113, A. 2d 601) on the remand of the *New Britain* case. Citing that case, the majority reasoned that "expenses

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[13] *Stadelman v. Harnell Woodworking Corp.*, 172 F. Sup. p. 156.

[14] *Metropolitan Life Ins. Co. v. United States*, 9 App. Div. 2d 356, 194 N.Y.S. 2d 168 (1st Dept., 1959); *Co-operative Loan and Sav. Soc. v. McDermott*, 14 App. Div. 2d 590, 218 N.Y.S. 2d 268 (2d Dept., 1961); *First Fed. Sav. & Loan Ass'n v. Lewis*, 14 App. Div. 2d 150, 218 N.Y.S. 2d 857 (2d Dept., 1961).

[15] *Buffalo Savings Bk. v. Victory*, 13 App. Div. 2d 207, 215 N.Y.S. 2d 189 (4th Dept., 1961; R. 64-68). In accord see *Dunkirk Trust Co. v. Dunkirk Laundry Co.*, 17 Misc. 2d 298, 182 N.Y.S. 2d 381 (Chautauqua County Court); but see, *contra*, *Kronenberg v. Ellenville Nurseries & Greenhouses*, 22 Misc. 2d 247, 196 N.Y.S. 2d 106 (Sullivan County Court); *First Federal Sav. & Loan Ass'n of Port Jervis v. Levy*, 31 Misc. 2d 459, 222 N.Y.S. 2d 908 (Sullivan County Court); and *Rikoon v. Two Boro Press, Inc.*, 9 Misc. 2d 591, 171 N.Y.S. 2d 19 (S. Ct., Kings County), modified on other grounds, 8 App. Div. 2d 986, 190 N.Y.S. 2d 790 (App. Div., 2d Dept.), appeal dismissed, 9 App. Div. 2d 783, 193 N.Y.S. 2d 302 (2d Dept., 1959). See the comment on the latter case, made by the Appellate Division in its second opinion in the instant case (R. 65).

of sale have always been determined by State, rather than Federal, law * * * (R. 79–80).[16]

We do not question that the actual expenses of a mortgage foreclosure are entitled to priority of payment out of the proceeds of sale over all lien claimants. Neither do we question the right of a mortgagee, who has paid local taxes prior to the filing of the federal tax lien, to add the amount thereof to his mortgage, and have priority therefor. But local taxes are obviously not part of the expenses of foreclosing a mortgage, and a State may not, by classifying them as such, accord them priority over earlier federal tax liens. This was not what was done in the *New Britain* case, for the expenses allowed by the Connecticut court on the remand of that case did not encompass local real estate taxes. See *Brown* v. *General Laundry Service*, *supra*.

Whatever may be the priority status of the actual costs of disposing of encumbered property,[17] it is clear that a state cannot alter the federal rules of priority

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[16] The Court also attempted to support its conclusion by citing *United States* v. *Brosnan*, 363 U.S. 237, in which the Court adopted state procedures for divestiture of junior liens as federal law. We treat the majority's position that *Brosnan* requires adoption of a state's definition of expenses of sale, *infra*, pp. [redacted].

[17] The costs and expenses allowed in mortgage foreclosure proceedings by New York law are set forth at Sections 554 and 555, 49 McKinney's Consolidated Laws of New York Annotated (Part 2). See also Wiltzie, *Mortgage Foreclosure* (5th ed., 1939), Vol. 2, Sec. 929 *et seq.*, Vol. 3, Sec. 1007. The New York Court of Appeals has distinguished between expenses of "sale" which, as defined in Section 1087, includes unpaid taxes and assessments, and expenses to "foreclose." *Wesselman* v. *Engel Co.*, 309 N.Y. 27, 127 N.E. 2d 736.

of liens by merely designating a particular type of state lien—*which is totally unrelated to the actual cost of sale of encumbered property*—as an "expense" of the "sale" of the foreclosed property. To recognize any such state power to determine priorities by a mere change in terminology is to authorize the state to subordinate earlier-arising federal tax liens to any state-created lien the state chooses to call an expense of the foreclosure action. As the dissenting opinion points out (R. 84):

> [C]alling the local taxes "expenses of the sale" does not help the local taxing authority, for it is to substance, not form, that the courts look. Local taxes do not result from the mortgage foreclosure sale; on the contrary, they are pre-existent to the sale. Accordingly, the State's characterization of them as "expenses of the sale"—appropriate though it may be for the State's own purposes—is thoroughly unreal in our present context and completely ineffectual to affect the priority of the Federal lien.

Moreover, as Judge Fuld points out (R. 88–89), at the time the federal tax lien arose and attached to the mortgaged property as a choate and perfected lien, the local taxes here involved had not even come into being. They might never have become liens against the property, since they might have been paid by the mortgagor or the property might have been foreclosed before they became due. In that event, the federal tax lien could have been satisfied out of the proceeds of the sale after payment of proper expenses and of the amount

due on the mortgage plus interest to the date of payment. Thus, the liens of the local authorities had at best only a potential existence (R. 89) "It comports neither with reality nor with law to give such 'potential liens' priority over the pre-existing matured Federal lien by labeling them 'expenses of the sale' in foreclosure proceedings."

3. United States v. Brosnan, 363 U.S. 237, does not call for the application of the New York statutory provisions which treat the payment of liens for local taxes as an expense of a mortgage foreclosure sale, so as to defeat the priority of the federal lien.

In *United States* v. *Brosnan*, 363 U.S. 237, the United States contested the validity of state procedures which provided that a senior mortgagee might divest the claims of junior lienors (including the United States) without recourse to a judicial sale. The Court noted that, while federal law determines what are permissible divestiture procedures, Congress had not entered the field. Under the circumstances, it found it desirable to adopt as federal law the state law on the theory that "in this instance" the need for uniformity is outweighed by the severe dislocation to local property relationships which would result from disregarding state procedures. Accordingly, it held that the junior lien of the United States had been extinguished.

The court below found in *Brosnan* a departure from this Court's holding in *New Britain* (R. 80–81), in that the divestiture decree affirmed in *Brosnan* had provided for the payment of local taxes out of the

foreclosure sale."[*] However, this Court was not asked to consider and did not pass upon the validity or effect of the sheriff's payment of such taxes, for the only contested issue involved the propriety of the state procedures for foreclosure. See Judge Fuld's discussion of this point in his dissenting opinion (R. 89–90).

Nor does the Court's decision in *Brosnan* of the issue presented to it—whether Congress had superseded state procedures for the divestiture of junior liens—lend support to the conclusion of the majority. Sections 1082 and 1087 of the New York Civil Practice Act do not establish procedures for the divestiture of liens or for any other purpose. They deal with the order of payment of claims, a substantive matter of priorities which *Brosnan* makes clear is governed not by state law but by Section 3670 as interpreted in *New Britain*, 363 U.S. at 240–241.

The dislocation to local property relationships which concerned the Court in *Brosnan* would not result in this case from giving the federal lien the priority to which it is entitled. The fears for municipal revenues and the health of municipal bonds expressed by the majority (R. 82–83) over application of the *New Britain* rule are without merit. Indeed,

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[*] The Third Circuit's opinion (264 F. 2d at 764) merely noted without comment that the amount bid by the purchaser at the sheriff's sale "went to satisfy costs of the sale, and for various outstanding local taxes." The opinion in *Brosnan* also cites *New Britain* in support of the statement (363 U.S. at 241) that the "property" to which the federal lien can attach "is not diminished by the particular means of enforcement possessed by a competing lienor to whom federal law concedes priority."

similar arguments made by the City in the *New Britain* case, and by the mortgagee in *United States* v. *Union Central Life Ins. Co.*, 368 U.S. 291, were rejected by this Court. Under the rule of the *New Britain* case, the States do not lose the priority of their taxes over mortgages. As pointed out by Seligson, *op. cit.*, p. 285, the States do not need protection in this respect. As between the State and the mortgagee, the former is entitled to priority of payment and it receives its taxes at the expense of the mortgagee. Concededly, the interest of the mortgagee is diminished to the extent that local taxes are paid from the mortgagee's share of the proceeds of the foreclosure sale. However, as the New York Court of Appeals has stated, the purpose of Section 1087 is to protect not the mortgagee, but the purchaser at a foreclosure sale who is entitled to clear title (*Wesselman* v. *Engel Co.*, 309 N.Y. 27, 127 N.E. 2d 736). Nevertheless, as Judge Fuld points out in his dissenting opinion (R. 90), the mortgagee is not left without recourse where the mortgagor is liable for payment of the debt secured by the mortgage and is not insolvent, for "In such a case, the mortgagee may collect the 'residue' or balance due from the mortgagor by way of a deficiency judgment" (citing Sections 1082 and 1083 of the New York Civil Practice Act, Appendix, *infra*, p. 34). Furthermore as Seligson, *supra*, also points out (p. 285):

> Acceptance of the view of the majority in *Buffalo Savings* will compel the federal government to initiate proceedings for the foreclosure of its liens immediately after those liens

arise. The forced sale of property subject to government liens will certainly not be beneficial to the economy of the country. But the government will have no practical alternative. Any delay in foreclosing is bound to prejudice the government. Neither the local taxing authority nor the mortgagee need take any action to collect or compel the payment by the mortgagor of accruing real estate taxes. Whatever the delay on the part of the local taxing authority, its taxes will have priority over the federal lien whenever foreclosure occurs. If the mortgagee desires to avoid a real estate tax foreclosure sale he need only pay taxes as they accrue and add these taxes to the mortgage debt, thus maintaining his priority over the federal tax lien. *It cannot be that Congress intended this result to follow from the language used in the federal tax lien statutes.* [Emphasis added.]

4. The rules of priority established by New Britain *do not give way where state law creates a "circular priority" of liens*

Section 3672 of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 33) affords the mortgage lien first priority here because the mortgage was executed and recorded in 1946 (R. 31–32), seven years prior to 1953 when the United States filed notice of its tax lien and more than 10 years before the liens for city and county real estate taxes and sewer rents attached in 1957 and 1958. New York law, however, grants the city and county liens priority over the mortgage without reference to the later dates of their attachment. This presents a problem of "circular priority" of liens.

Noting the conflict between satisfaction of the mortgagee's first priority under federal law and respect for state rules for determining the priority of non-federal liens *inter se*, the majority below held that the rule of "first in time, first in right" (*United States* v. *New Britain, supra,* at 87) does not apply in cases of circular priority (R. 77). The majority attempted to justify its holding by suggesting that *New Britain* so held or that if it did not, the ruling "is too far removed in the light of the real issue here * * *" (R. 77). This suggestion was plainly error.

It is clear beyond dispute that in *New Britain* this Court was faced with and deliberately resolved the very question of circular priority of state and federal liens that alone is in issue in this case. See 347 U.S. at 87–88. In *New Britain*, state law granted the local tax liens a priority over mortgage liens.[*] Federal law, as there determined by this Court, established the following order or priority: (1) mortgage lien; (2) federal tax liens; (3) state tax liens. Both the Connecticut Supreme Court of Errors and this Court agreed that no provision of federal law prevented the state from giving priority to various state liens (such as real estate tax and water-rent liens) over mortgages and judgments. It therefore was apparent that a mortgagee would enjoy the full benefit of its mortgage only if the federal lien were subordinated to any state lien which the state chose to make prior in right to a

[*] See the first opinion of the Connecticut Supreme Court of Errors in *New Britain*, reported *sub nom. Brown* v. *General Laundry Service, Inc.*, 139 Conn. 363, 94 A. 2d 10.

mortgage lien. This Court took careful note of this inevitable consequence but nevertheless unequivocally concluded that federal rules alone determine the priority of the federal tax lien and that these rules are unaffected by any burden of subordination the state may choose to impose upon the mortgage lien which the federal statute respects. The Court held (347 U.S. at 88) that:

> The United States is not interested in whether the State receives its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgage and judgment creditors, Congress intended to assert the federal lien. There is nothing in the language of § 3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein, and the legislative history lends support to this impression.

In sum, federal law was held to determine the relative priority of a federal tax lien vis-a-vis any and all state liens, regardless of inconsistent state law. State law was left free to determine the relative priorities of non-federal liens among themselves.

Actually the court below has resolved the problem of circular priorities by eliminating it; it has held that the federal tax lien is always subordinate to municipal tax liens, regardless of their respective priorities in time. On its view, even absent a senior mortgage, later-assessed and perfected local real estate tax liens can themselves be foreclosed by a sale free and clear of prior federal tax liens (R. 83). But

the foundation of the *New Britain* decision, as we have demonstrated above, is the priority of the federal tax lien over later-arising local tax liens because both are of equal dignity and to be paid in order of first in time, first in right. The decision below subverts this basic principle of federal tax lien law.

C. OTHER COURTS HAVE CONSISTENTLY REJECTED THE GROUNDS ON WHICH THE MAJORITY BELOW ATTEMPTED TO DISTINGUISH *NEW BRITAIN* AND HAVE HELD THE FEDERAL TAX LIEN ENTITLED TO PRIORITY IN CASES INDISTINGUISHABLE FROM THIS

There are no authoritative decisions which support the lower court's attempted distinctions of *New Britain*. On the contrary, the federal and state courts have repeatedly rejected such distinctions and have uniformly upheld the priority of the federal tax lien in cases indistinguishable from the instant case. *United States* v. *Bond*, 279 F. 2d 837 (C.A. 4), certiorari denied, 364 U.S. 895; *United States* v. *Christensen*, 269 F. 2d 624 (C.A. 9); *United States* v. *Wasserman*, 257 F. 2d 491 (C.A. 1); *United States* v. *Costas*, 142 So. 2d 699 (Ala. Sup. Ct.); *Union Central Life Ins. Co.* v. *Peters*, 361 Mich. 283, 105 N.W. 2d 196, reversed on other grounds, *sub nom. United States* v. *Union Central Life Ins. Co.*, 368 U.S. 291; *First Nat. Bank of Chippewa Falls* v. *Henneman Co.*, 10 Wis. 2d 260, 103 N.W. 2d 24, certiorari denied, 364 U.S. 836; and *Southern Ohio Savings Bank & Trust Co.* v. *Bolce*, 165 Ohio St. 201, 135 N.E. 2d 382. See also *American Surety Co.* v. *Sundberg*, 58 Wash. 2d 337, 363 P. 2d 99, certiorari denied, 368 U.S. 989, and

Samms v. Chicago Title & Trust Co., 349 Ill. App. 413, 111 N.E. 2d 172.[38]

In *Bond*, real estate taxes had accrued and were paid by the mortgagee subsequent to the recordation of the notice of the federal tax lien. The court rejected the mortgagee's contention that the "inchoate lien test" was not applicable in view of the fact that a federal tax lien is not valid against a mortgagee under Section 6323(a) of the 1954 Code (Section 3672(a) of the 1939 Code) until recorded. The court held (279 F. 2d at 846) that "the claimed priority for payment of the real estate taxes accruing after recordation of the federal tax liens, even though made pursuant to an authorized provision of a prior recorded mortgage, must be subordinated to the federal tax lien because such lien so acquired by the mortgagee was unperfected and inchoate at the time the federal tax liens were recorded."

Under facts identical to those in *Bond*, the Ninth Circuit in *United States* v. *Christensen*, 269 F. 2d at 624–625, held that the federal sovereign was not to be frustrated in the collection of its revenue by the tax-priority laws of half a hundred different states, and that, once a federal tax lien had been duly recorded, it became senior in right to the claims of a prior mortgagee who had paid city or state taxes subsequent to the assess-

[38] In the *Sundberg* case it was held that a mortgage which secured future advances was superior to a federal tax lien only to the extent of the advances made before the filing of notice of the federal lien; in *Samms*, it was held that a mechanics lien which, under state law, was superior to a mortgage lien was inferior to a federal tax lien which in turn was subordinate to the mortgage.

ment of the federal taxes and the filing of notices thereof. In such a case, the court added, the ancient maxim "The first in time is the first in right" has "a peculiarly salutary application."

Nor may *Bond* and *Christensen* be distinguished on the ground that the mortgagee paid the local taxes which fell due following the filing of notice of the federal tax lien. There is no difference in principle between giving subsequent local taxes priority over the federal tax lien and permitting the mortgagee to pay them and add the amount thereof to the mortgage debt. Neither is there any difference in principle or effect between designating such local taxes as "expenses of the sale" and ordering the property sold "subject to" those taxes but free and clear of the federal tax liens.[21] In either of those situations, the state is attempting to give its subsequently accruing local taxes priority over the federal tax lien. The *New Britain* case makes it clear that Congress did not intend that the federal tax lien should be subordinated to junior encumbrances having priority over mortgages and judgment liens simply because the federal lien was subordinate to such mortgages and judgment liens.

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[21] Prior to the decision of the New York Court of Appeals in the instant case, the New York Supreme Court (Nassau County) ordered a sale of mortgaged property "subject to" local taxes, thereby according those taxes priority over federal tax liens. (*Feinstein* v. *Earl*, 228 N.Y.S. 2d 643.) Subsequent to the decision in the instant case, and upon the authority thereof, the Appellate Division, 2d Department, affirmed the ruling of the Nassau County Court. Application for leave to appeal has been filed by the United States and is still pending.

CONCLUSION

The judgment of the New York Court of Appeals should be reversed and the case should be remanded with directions to award priorities in accordance with the rule of the *New Britain* case, as directed by the Appellate Division in its order and opinion of May 18, 1961 (R. 60–68).

Respectfully submitted.

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SEPTEMBER 1962.

APPENDIX

Internal Revenue Code of 1939 (26 U.S.C., 1952 ed.):

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 3672 [as amended by Sec. 401 of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 505 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien without Notice.*—Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) *Under state or territorial laws.*—In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by

law authorized the filing of such notice in an office with the State or Territory; or

* * * * *

6A Gilbert-Bliss Civil Practice of New York, Annotated (recompiled 1944):

SEC. 1082. *Final judgment; surplus moneys:*

1. In an action to foreclose a mortgage upon real property, if the plaintiff becomes entitled to final judgment, it must direct the sale of the property mortgaged or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale and the costs of the action except as provided in subdivision two of this section. All surplus moneys arising from the sale of mortgaged premises under any judgment shall be deposited by the officer appointed to conduct the sale of the premises within five days after the same shall be received and be ascertainable to the credit of the action in a bank or trust company named by the court in the final judgment unless otherwise specially directed, subject to the further order of the court; and every judgment in foreclosure shall contain such directions, except where other provisions are made specially by the court. * * *.

SEC. 1083. *Judgment for deficiency; limitation.*

If a person who is liable to the plaintiff for the payment of the debt secured by the mortgage is made a defendant in the action, and has appeared or has been personally served with the summons, the final judgment may award payment by him of the whole residue, or so much thereof as the court may determine to be just and equitable, of the debt remaining unsatisfied, after a sale of the mortgaged property and the application of the proceeds, pursuant to the directions contained in such judgment, the amount thereof to be determined by the court as herein provided. * * *.

* * * * *

SEC. 1087. *Payment of taxes, assessments and water rates out of proceeds of sale.*

Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. * * *.

McKinney's Consolidated Laws of New York, Annotated:

New York Lien Law:

SEC. 240(1). [1962 Cum. Supp.]

Notices of liens upon real property for taxes payable to the United States of America and certificates releasing or discharging such liens shall be filed in the office of the clerk of the county in which real property subject to any such lien is situated. * * *.

New York Public Authorities Law:

SEC. 1180.

* * * The [Buffalo Sewer] authority shall hear and examine any such complaints and may modify the proposed schedule and shall adopt a final schedule of sewer rents within sixty days after the date of said notice. * * * From and after the due date thereof, such sewer rents shall constitute a lien upon the real property served by the facilities. Such lien shall have the same priority and superiority as the lien of the general tax of the city. * * *

New York Real Property Tax Law:

SEC. 902. [Historical Note]

The amount of all taxes and assessments levied by the board of supervisors under this chapter or other law, upon any parcel of real property located in the county shall, except as specifically otherwise provided, be and become a lien thereon as of the first day of January of the fiscal year for which such taxes and assessments are levied and shall remain such a lien until paid.

Erie County Tax Act:

SEC. 6-2.0, Laws of 1942, Ch. 812.

* * * After the board of supervisors shall have duly completed the tax rolls of the several cities and towns of said county, the taxes and assessments thereon shall be and become liens as of the first day of January next ensuing the levy thereof and shall remain such liens until paid * * *.

City of Buffalo Charter (1950):

SEC. 534.

All taxes and assessments, together with interest thereon as provided by law, shall be liens upon the lands upon which they are assessed from the time of publication of the notice by the board of assessors required by section five hundred ninety until paid and shall be preferred in payment to all other charges. Taxes and assessments upon the general tax rolls may be paid and shall have priority in the inverse order of time in which they become liens, and all taxes and assessments which are now liens on the property assessed shall continue to be liens until paid.

SEC. 590.

On or before June twentieth in each year the board of assessors shall publish a notice in the

publication or publications designated by the council that the payment of local assessments returned on the general tax roll and the general city tax on said roll may be made to the city treasurer at the times, and in the manner and with the additions provided in the next succeeding sections.

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No. 96

IN THE

Supreme Court of the United States

October Term, 1962

UNITED STATES OF AMERICA, *Petitioner*,

v.

BUFFALO SAVINGS BANK

On Writ of Certiorari to the Court of Appeals of the State of New York

BRIEF OF AMERICAN BAR ASSOCIATION, AMICUS CURIAE, IN SUPPORT OF RESPONDENT

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INDEX.

	Page
Jurisdictional Statement	1
Interest of *Amicus Curiae*	2
Summary of Argument	6
Argument	
I. This Court should re-examine its conclusion that liens for federal taxes and for real property taxes take rank in order of time	8
II. Contrary to the clear direction of Section 3672(a) of the Internal Revenue Code of 1939, the prior mortgagee is deprived of the protection intended by Congress if the subsequent property taxes must be paid from its share of the proceeds	11
III. Controlling force of state law	19
Conclusion	21

CITATIONS

Cases:

Allen v. Diamond T Motor Car Co., 291 F. 2d 115	5
Aquilino v. United States, 363 U.S. 509	6, 8, 10, 21
Barack v. City of New York, 268 F. 2d 412	11, 19
Brine v. Hartford Fire Insurance Co., 96 U.S. 627	16
City of New Brunswick v. United States, 276 U.S. 547	11
Commissioner v. Stern, 357 U.S. 39	20
Continental Casualty Co. v. Schaefer, 173 F. 2d 5, cert. denied, 337 U.S. 940, 338 U.S. 820	20
Crest Finance Co. v. United States, 368 U.S. 347, rev'g 291 F. 2d 1	5
Erie Railroad Co. v. Tompkins, 304 U.S. 64	7, 20
First National Bank of Chippewa Falls v. Charles Bonneman Co., 10 Wisc. 2d 260, 103 N.W. 2d 24, cert. denied, 364 U.S. 836	13
Gauvey v. United States, 291 F. 2d 42	5

Page

International Harvester Credit Corp., v. Goodrich, 350 U.S. 537 20
Morgan v. Commissioner, 309 U.S. 78 8
Osterhaus v. Union Trust Co., 93 U.S. 424 9
Paddell v. City of New York, 211 U.S. 446 ..... 9, 11
Pettack v. Mellott, 41 Del. 361, 22 Atl. 2d 843 10
United States v. Acri, 348 U.S. 211 20
United States v. Ball Construction Co., 355 U.S. 587 ..... 4, 5
United States v. Boss, 357 U.S. 51 ..... 8, 10
United States v. Bond, 279 F. 2d 837, *cert. denied*, 364 U.S. 895 ..... 5, 16, 18
United States v. Brosman, 363 U.S. 237 17
United States v. Burnison, 339 U.S. 87 10
United States v. Christenson, 269 F. 2d 624 ..... 18, 21
United States v. City of New Britain, 347 U.S. 81 ..... 6, 7, 8, 9, 11, 13, 15
United States v. Colotta, 350 U.S. 808, *rev'g* 224 Miss. 33, 79 So. 2d 454 5
United States v. Curry, 201 F. 2d 371 14
United States v. Durham Lumber Co., 363 U.S. 522 ..... 9, 10, 21
United States v. Fox, 94 U.S. 315 10
United States v. Gilbert Associates, 345 U.S. 361 16
United States v. Hulley, 358 U.S. 66, *rev'g* 102 So. 2d 529, which *aff'd* 58-2 U.S.T.C. ¶ 9802, 2 A.F.T.R. 2d 5886 5
United States v. Perkins, 163 U.S. 625 10
United States v. Pioneer American Ins. Co., 235 Ark. 267, 357 S.W. 2d 653, pending as No. 405, this Term 5
United States v. Roessling, 280 F. 2d 933 11
United States v. Security Trust & Savings Bank, 340 U.S. 47 14
United States v. Snyder, 149 U.S. 210 14
United States v. State of California, 281 F. 2d 726 .. 10
United States v. Vorreiter, 355 U.S. 15, rev'g 134 Colo. 543, 307 P. 2d 473 5
United States v. White Bear Brewing Co., 350 U.S. 1010, *rev'g* 237 F. 2d 359 ..... 4, 5
Van Brocklin v. Tennessee, 117 U.S. 151 10
Washington Square, Slum Clearance, Matter of, 5 N.Y. 2d 300, 157 N.E. 2d 587, *cert. denied sub nom. United States v. Coblentz*, 363 U.S. 841 21

CONSTITUTION AND STATUTES:

Page

U. S. Constitution Art. 1, Sec. 8, cl. 1 21
Internal Revenue Code of 1939, Sec. 3672(a) (now Internal Revenue Code of 1954, Sec. 6323(a)) ..6, 7, 11, 12, 13, 15, 16
Revised Statutes Secs. 3466-3467, 31 U.S.C. Secs. 191-192 3

MISCELLANEOUS:

H. Rep. No. 4018, 62d Cong., 2d Sess. 14
84 C.J.S., Taxation Sec. 57, page 157 10
Report of the Special Committee on Federal Liens, American Bar Association, 84 A.B.A. Rep. 645 2, 13, 19
Report of the Committee on Relative Priority of Government and Private Liens, Section of Real Property Probate and Trust Law (A.B.A.), Proceedings (1958) Part II, 81 19

IN THE

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No. 96

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On Writ of Certiorari to the Court of Appeals of the State of New York

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BRIEF OF AMERICAN BAR ASSOCIATION, AMICUS CURIAE, IN SUPPORT OF RESPONDENT

JURISDICTIONAL STATEMENT

This brief is respectfully filed, pursuant to Rule 42, paragraph 1, of the Rules of this Court, by authority of a resolution of the Board of Governors of the American Bar Association and with the written consent of Petitioner and Respondent. Such written consents are submitted herewith.

INTEREST OF AMICUS CURIAE

The American Bar Association, representing about 112,000 lawyers throughout the United States, has long been seriously concerned about the impact of federal tax liens, as their scope and priority have been progressively extended by decisions of this Court and the lower courts. Following studies by several Sections of the Association, the House of Delegates in 1958 created a Special Committee to consider and recommend comprehensive remedial legislation. The Committee repoted that—

> "This extension of the scope of the federal tax lien and the uncertainties the decisions have created have had a severe impact on innumerable business and commercial transactions, and have caused increasing concern on the part of many lawyers throughout the country."[1]

The Committee's legislative proposals were approved by the House of Delegates on February 23, 1959, and bills were introduced in Congress.[2] It is anticipated that hearings will be held on the bills after a report on the bills has been received from the Treasury Department. It is recognized that the ultimate resolution by the Congress of the Association's legislative proposals is of no present concern to this Court. The pendency of the proposals is brought to the Court's attention, however, in order to emphasize the need for a full opinion in the disposition of this case, defining the limits of the powers of the federal and state legislatures in the area.

[1] The report is found in volume 84 of the Reports of the American Bar Association (1959), page 645.

[2] In the current Congress, the bills were designated H.R. 4319 and 4320, and S. 1193. They will be reintroduced in 1963.

The proposed legislation would completely revise the provisions of the Internal Revenue Code of 1954 with respect to federal tax liens and levies, as well as sections 3466 and 3467 of the Revised Statutes (31 U.S.C. §§ 191 and 192) relating to priorities in insolvency, and certain provisions of the Judicial Code relating to procedures for the enforcement of mortgages and liens on property in which the United States has an interest. The approach taken in the proposed legislation is that Congress should expressly state in detail its intentions on many issues on which the federal tax collector has come in conflict with business, municipal and other interests (not themselves liable for the payment of the tax in question), and which the courts heretofore have been forced to resolve on the basis of general statutory language probably not framed with such problems in mind.

The decision below, so far as it rests on the view that property taxes are defined by state law as expenses of the foreclosure sale and must for that reason be paid before federal tax liens are satisfied, presents the issue how far a state legislature's characterization of a claim may control the priority of federal liens. Related to this point is the view of some who have studied these problems for the American Bar Association (whose views are summarized in Part III of this brief) that the States have never surrendered their sovereign power to determine substantive rights, including property rights, and that such power extends to the determination of the priority of property taxes and other liens *vis-a-vis* the federal tax lien. Resolution of that issue by this Court will be helpful to Congress in considering the proposed legislation, which would certainly take a very different form if such view is the correct one.

Apart from the above-described general interest of the Association, the specific problem presented in this litigation is of concern to many besides the particular litigants. Banks, savings and loan associations, insurance companies and all other mortgage lenders will be vitally affected if this Court should uphold the Petitioner's claim that, in every case of insufficiency of mortgage-sale proceeds, the prior mortgagee, in effect, must pay, out of its share of the proceeds, the state and local property taxes which accrued after notice of the federal tax lien was filed. Such a ruling could impair the security of many mortgages, no matter how amply they may have seemed to be covered by the equity in the property. The Association desires to bring such adverse effects on normal business transactions to the attention of the Court, and to suggest reasoning by which such effects may be avoided.

While the issue herein arises between the Government and a mortgagee, there are other instances in which it is the state or local government which suffers. The issues, therefore, involve the relationships between the Federal Government and state and municipal governments, and the ability of the latter to finance their vital functions from their primary revenue source—the real property tax.

It is of particular concern to the Association to urge that a full opinion be rendered on this subject, so that lawyers and their mortgagee clients may not be left in uncertainty. Regrettably, in the past development of the law of federal tax liens, issues have seemed so clear to a majority of this Court that they have been disposed of *per curiam*,[3] leaving the bar and the lower

[3] Most notably in the landmark decisions in *United States v. White Bear Brewing Co.*, 350 U.S. 1010 (1956), and *United States v. Ball Construction Co.*, 355 U.S. 587 (1958).

courts to speculate concerning the reasoning of this Court and the intended scope of the principles established.[4] As a result, the lower courts have often fallen into error in their attempts to apply such decisions.[5]

[4] As the court below stated:

> "Although the United States Supreme Court in recent years has passed on the question of priority of liens and the resulting effects upon mortgagees, their decisions provide no clear command governing us here." (R. 75.)

In similar vein, the Court of Appeals for the Seventh Circuit, speaking of the *Ball Construction Co.* case, *supra*, note 3, declared:

> "It is to be regretted that in deciding a question that would, necessarily, often be considered by the bench and bar, the reasons given by the majority for its decision were confined to less than three lines." *United States* v. *Crest Finance Co.*, 291 F. 2d 1, 4 (7th Cir. 1961), *rev'd*, 368 U.S. 347 (1961).

[5] Thus, it required four successive *per curiam* decisions to bring the thinking of the lower courts in line with this Court's briefly expressed views on mechanic's lien priorities. *United States* v. *Calotta*, 350 U.S. 808 (1955), *rev'g* 224 Miss. 33, 79 So. 2d 474 (1955); *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010 (1956), *rev'g* 227 F. 2d 359 (7th Cir. 1955); *United States* v. *Vorreiter*, 355 U.S. 15 (1957), *rev'g* 134 Colo. 543, 307 P. 2d 475 (1957); *United States* v. *Hullen*, 358 U.S. 66 (1958), *rev'g* 102 So. 2d 590 (Fla. 1958), which *aff'd* 3802 U.S.T.C. ¶ 9802, 2 A.F.T.R. 2d 5886 (Fla. Cir. Ct. 1956). A series of decisions misapplying *United States* v. *Ball Construction Co.*, *supra*, note 3, to the detriment of security assignments perfected before the federal tax lien arose, was finally brought to a halt by this Court, on confession of error by the Government, in *Crest Finance Co.* v. *United States*, 368 U.S. 347 (1961). But other attempted applications of the *Ball* decision have led to still unresolved conflicts. *Cf. Allen* v. *Diamond T Motor Car Co.*, 291 F. 2d 115 (10th Cir. 1961), with *Gauvey* v. *United States*, 291 F. 2d 42 (8th Cir. 1961) (regarding effect of non-recording of the private interest). Compare also *United States* v. *Bond*, 279 F. 2d 837 (4th Cir. 1960), *cert. denied*, 364 U.S. 895 (1960), with *United States* v. *Pioneer American Ins. Co.*, 235 Ark. 267, 357 S.W. 2d 653 (1962) (pending as No. 405, this Term), and with the decision below.

With the benefit of a full decision, whether favorable or unfavorable, mortgagees and their counsel may at least know where they stand, and Congress may be relieved of futile debate concerning the extent of its power to modify the established priority rules.

SUMMARY OF ARGUMENT

Amicus curiae suggests that the rule of *United States v. City of New Britain*, 347 U.S. 81 (1954), preferring federal tax liens to subsequent real property tax liens, be re-examined in the light of *Aquilino v. United States*, 363 U.S. 509 (1960), and other recent decisions. The virtually universal principle of state law that liens for real property taxes are not controlled by the "first-in-time, first-in-right" principle, but are superior to all liens on the property, results from the fact that such taxes are levied upon the land itself, without regard to the separate interests therein. In exercising its undoubted right to regulate the tenure of real property within its jurisdiction, the State has made it a condition to the ownership of property that annually recurring charges for the services of government benefiting the property be paid. The practical effect of the *New Britain* rule may be to remove property from the local tax rolls—while it is still possessed and enjoyed by the delinquent taxpayer—until such time as the federal tax collector elects to enforce the lien by sale.

Further, *amicus curiae* suggests that the Court has not had adequate opportunity to consider the bizarre results which the rule of "circular priority" inflicts upon mortgagees, in violation of the intent of Section 3672(a) of the Internal Revenue Code of 1939 (now Section 6323(a) of the Internal Revenue Code of

1954), since the prior mortgagee and judgment creditor were not made parties to the *certiorari* proceeding in *New Britain*. Congress enacted the predecessor of Section 3672(a) in order to "facilitate business transactions" by protecting mortgagees against secret or after-arising federal tax liens. That enactment did not merely subordinate the federal lien to the *amount* of the mortgage debt; it made the federal lien *invalid* against *the mortgagee*, and thus was intended to protect the mortgagee in all its customary contractual rights, including the right to be indemnified against subsequent property taxes.

The severe dislocations in the mortgage market which would result from imposing unmeasurable new risks on mortgagees afford a further reason for applying the universal state rule of priority in this situation. The threat to the economy envisioned by the Government, if it is compelled to enforce its liens promptly in order to escape diminution of its interest by accruing property taxes, is no different from the effect which the Government's position would have in forcing mortgagees to declare a default and foreclose promptly for like reason.

The view of certain members of the American Bar Association that *Erie Railroad Co.* v. *Tompkins*, 304 U.S. 64 (1938), makes state law constitutionally conclusive with respect to the relative priority of federal and other liens is set out herein for the consideration of the Court.

ARGUMENT

I. This Court Should Re-examine Its Conclusion That Liens for Federal Taxes and for Real Property Taxes Take Rank in Order of Time

In *United States* v. *City of New Britain*, 347 U.S. 81 (1954), this Court held that federal tax liens upon a solvent taxpayer's real estate and liens for local property taxes upon the same real estate take rank in the order in which such liens attached to the property and became choate. Real property tax liens arising subsequent to the federal tax liens were subordinated, notwithstanding a rule of state law (which is virtually universal) that real property tax liens are superior to all existing liens on the property.

Subsequently, in *Aquilino* v. *United States*, 363 U.S. 509, 512-514 (1960), this Court declared:

> "The threshold question in this case, as in all cases where the Federal Government asserts its tax lien, is whether and to what extent the taxpayer had 'property' or 'rights to property' to which the tax lien could attach. In answering that question, both federal and state courts must look to state law, for it has long been the rule that 'in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property . . . sought to be reached by the statute.' *Morgan* v. *Commissioner*, 309 U.S. 78, 82. Thus, as we held only two Terms ago, Section 3670 'creates no property rights but merely attaches consequences, federally defined, to rights created under state law . . .' *United States* v. *Bess*, 357 U.S. 51, 55. However, once the tax lien has attached to the taxpayer's state-created interests, we enter the province of federal law, which we have consistently held determines the priority of competing liens asserted against the taxpayer's 'property' or

> 'rights to property.' [Citations omitted.] The application of state law in ascertaining the taxpayer's property rights and of federal law in reconciling the claims of competing lienors is based both upon logic and sound legal principles. This approach strikes a proper balance between the legitimate and traditional interest which the State has in creating and defining the property interest of its citizens, and the necessity for a uniform administration of the federal revenue statutes." (Footnotes omitted.)

See also *United States* v. *Durham Lumber Co.*, 363 U.S. 522 (1960).

Amicus curiae suggests that the *New Britain* rule should be reexamined in the light of the above-cited decisions. The *New Britain* decision fails to recognize the essential difference between real property taxes and federal taxes generally.[6] Applying the first-in-time rule as between such liens is like trying to equate eggs and oranges. Both may be food, but there the similarity ends.

As the court below pointed out (R. 78), property taxes in New York (and, in fact, in most States) are not levied against the landowner as such, but are levied upon the land itself, for essential services supplied for the benefit of the land, without regard to the separate interests therein and liens thereon. See also *Paddell* v. *City of New York*, 211 U.S. 446 (1908); *Osterberg* v. *Union Trust Co.*, 93 U.S. 424 (1877). It is the un-

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[6] The *New Britain* decision did consider one asserted difference, that the property tax was a lien on the specific property on which it was assessed, while the federal tax lien was general. That difference was held not to affect their relative priority. But the present argument does not appear to have been considered.

doubted right of the States to regulate the tenure of real property within their jurisdiction. *United States* v. *Fox*, 94 U.S. 315 (1877). See also *United States* v. *Barnison*, 339 U.S. 87 (1950); *United States* v. *Perkins*, 163 U.S. 625 (1896). In the exercise of that right, the States, in effect, have made it a condition to the ownership of real estate, or of any interest therein, that those annually recurring charges for the services of government be paid.[7] If these taxes are not paid, there is a steady diminution of the property interest, pursuant to this condition attached to the right of ownership. Under the rule of *Bess*, *Aquilino* and *Durham*, *supra*, the federal tax lien attaches only to the taxpayer's property rights as created and defined by state law. As so created and defined, the taxpayer's interests are subject to the condition that those continuing charges be met. *United States* v. *State of California*, 281 F. 2d 726 (9th Cir. 1960).

While this Court has held that properties purchased by the United States at tax sales are not subject to property taxation while so owned (*Van Brocklin* v. *Tennessee*, 117 U.S. 151 (1886)), it never has been sup-

[7] The court below stated, "Our State law has not characterized the nature and extent of the Federal tax lien, but has determined the nature and extent of the property interests of the taxpayer (admittedly a State function), which in the case of real property is conditioned upon the payment of annually recurring governmental land taxes. * * *." (R. 76.) In accord, see 84 C.J.S., Taxation, Sec. 57, page 157: "Generally speaking, all subjects over which the sovereign power of the state extends are objects of taxation, and there is *a tacit condition annexed to ownership of property* that it shall contribute to public revenue in such manner and in such proportion as the legislature shall direct." (Italics supplied.) Citing *Pollock* v. *Mellott*, 41 Del. 361, 22 Atl. 2d 843, 848 (1941).

posed that the mere existence of a federal tax lien on realty has the effect of relieving the realty from further property taxation. *City of New Brunswick* v. *United States*, 276 U.S. 547 (1928); *Borock* v. *City of New York*, 268 F. 2d 412 (2d Cir. 1959); *United States* v. *Roessling*, 280 F. 2d 933 (5th Cir. 1960). Yet (unless there is a prior mortgagee or other lienor to absorb the tax burden, as in the *New Britain* case) the practical effect of the "first-in-time" rule often may be to remove the property from the local tax rolls—while it is still possessed and enjoyed by the delinquent taxpayer—until such time as the federal tax collector elects to enforce the lien by sale. Since property taxes typically are charged only on the property assessed, and are not a personal liability of the owner or of any other person having any legal or equitable interest in the property (*Paddell* v. *City of New York*, *supra*), the state or local government would have no recourse against anyone for taxes accruing during the period of existence of a federal lien which exhausts the proceeds of the property.

II. Contrary to the Clear Direction of Section 3672(a) of the Internal Revenue Code of 1939, the Prior Mortgagee Is Deprived of the Protection Intended by Congress if the Subsequent Property Taxes Must be Paid from Its Share of the Proceeds

Under the rule of *New Britain*, in the particular circumstances of this case, the happenstance that there exists a prior mortgage means that the property taxes will be paid. The contest becomes one between the Federal Government and the prior mortgagee, as to whose share of the sale proceeds shall be diminished by the property tax payment.

Under the rule contended for by the Government, it is the mortgagee whose interest would be diminished, notwithstanding the fact that the mortgagee acquired its property interest before either class of tax liens arose and thus was "first-in-time." This result may be illustrated as follows:

A	B	C
(First in time)	(Second in time)	(Third in time)
$10,000 Mortgage Debt	$10,000 Federal Tax Lien	$1,000 Property Taxes Assessed After Federal Tax Lien
Superior to B, but inferior to C	Superior to C, but inferior to A	Superior to A, but inferior to B

Property is sold for $20,000

The Government's solution would be, first, to set aside the sum of $10,000, equal to the prior mortgage lien. The balance of $10,000 would then be applied to the federal tax lien. The $1,000 for property taxes then would be taken out of the sum set aside for the mortgage lien, with the result that the mortgagee, although superior by federal law (I.R.C. 1939, § 3672(a)) to the federal tax lien, would collect only part of its claim, while the federal lien would be satisfied in full.

Another example, with the parties identified as before:

A	B	C
$1,000	$10,000	$1,000

Property is sold for $10,000

In this situation, $1,000 would be set aside on account of the mortgage lien. The balance of $9,000 then would go to the Federal Government on its $10,000 tax lien. The $1,000 set aside on account of the mortgage

lien then would be applied on the property taxes. The mortgagee thus would lose everything while the state or municipality would collect 100% of its taxes, whereas, but for the adventitious circumstances that there was a prior mortgage lien, the state and local property tax would have been wiped out by the $10,000 federal lien. The presence of the prior mortgage lien permits payment of the property taxes, but the mortgagee's interest is wiped out in consequence.[8]

These results may fairly be characterized as bizarre.[9] Yet such results appear to be required by the language of the *New Britain* decision, *supra*. *New Britain*, however, was presented to this Court simply as a contest between federal liens and municipal liens—the prior mortgagee and judgment creditor not having been made parties to the *certiorari* proceeding. In the solution which this Court there adopted, both contestants in this Court were winners and the ultimate loser was the prior judgment creditor, a party not even represented in the proceeding in this Court. It therefore seems doubtful that this Court has had adequate opportunity to consider the position of mortgagees, pledgees and judgment creditors in this situation, or the full legislative history and analysis of Section 3672(a) of the Internal Revenue Code of 1939 next presented.

Section 3672(a) of the Internal Revenue Code of 1939 (now Section 6323(a) of the Internal Revenue

[8] For an instance where this occurred, see *First Nat'l Bank of Chippewa Falls v. Charles Henneman Co.*, 10 Wisc. 2d 260, 103 N.W. 2d 24 (1960), *cert. denied*, 364 U.S. 836 (1960).

[9] See report of the Special Committee on Federal Liens, *supra*, note 1, at 662.

Code of 1954) provides that the federal tax lien "shall not be valid as against any mortgagee, pledgee, . . . or judgment creditor until notice thereof has been filed. . . ." Congress thus expressed its clear intention to protect mortgagees, pledgees and judgment creditors against secret liens for federal taxes—and, *a fortiori*, against federal tax liens that, as in this case, did not even exist until seven years after the date of the mortgage. The provision originally was enacted in 1913, after the enactment of the corporate excise tax of 1909, greatly expanding the number of federal taxpayers, had made intolerable the effect of the decision in *United States* v. *Snyder*, 149 U.S. 210 (1893), under which bona fide purchasers and encumbrancers were subject to secret federal liens.[10] The Report of the House Committee on the Judiciary (H. Rep. No. 1018, 62d Cong., 2d Sess. (1912)) stated:

> "The recent act relating to excise tax on corporations makes it imperative that some legislation of this kind be enacted in order to protect the transfer of property, and to facilitate business transactions. *There is no reason why the Government should not occupy the same position with reference to liens on property as does the individual.*" (Italics supplied.)

Thus, whatever the intention of Congress may have been with respect to private liens not enumerated in the statute (see concurring opinion in *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 53 (1950)), Congress plainly intended that, as against

[10] The efforts of the American Bar Association to correct that situation are referred to in *United States* v. *Curry*, 201 Fed. 371, 374 (D. Md. 1912).

mortgagees and other enumerated classes, the federal tax lien should stand no better than any private lien. A private lien, junior to the mortgage, would not be satisfied until the mortgagee had been paid in full, after property taxes have been taken care of.

It should be noted that it is not merely the *amount* of the mortgage debt to which Congress subordinated federal tax liens; it is the "mortgagee." The requirements of Section 3672(a) are not satisfied by merely setting aside the *amount* of the debt, without regard to whether the mortgagee is made whole therefrom.

When it enacted the predecessor of Section 3672(a), Congress surely was aware of the historic fact that, *vis-a-vis* all other state-created interests, after-accruing property taxes are *not* controlled by the "first-in-time, first-in-right" principle but traditionally take first priority in all events. It may well be that, as this Court held in *New Britain*, Congress intended that the rule of "first-in-time, first-in-right" should apply where the contest is solely between the federal tax lien and subsequently-arising state liens. But where, as here, the contest is between the interests of mortgagees, pledgees or judgment creditors and a subsequently-arising federal tax lien, Congress has directed that the federal tax lien "shall not be valid as against any mortgagee, pledgee, . . . or judgment creditor . . . ," and since, where there are subsequently-arising property taxes, this can be accomplished *only* by according the subsequently-arising property tax liens their traditional priority, Congress necessarily must have intended that the "first-in-time, first-in-right" principle not apply to such property taxes. Only this construction comports with the literal mandate of the

statute—that after-arising federal tax liens "shall not be valid" against prior mortgagees, pledgees and judgment creditors.

Moreover, no other construction of Section 3672(a) squares with the clear statement in the contemporaneous Report of the House Committee on the Judiciary that, in respect of its rights *vis-a-vis* mortgagees and judgment creditors, the Federal Government should occupy the same position with reference to liens on property as does the individual private citizen.

Another analysis of Section 3672(a) confirms the foregoing. Congress surely was aware that mortgages commonly and usually require the mortgagor to keep the property taxes paid up, and that the performance of such covenant is itself secured by the mortgage—and is as essential a part of the mortgage as the promise to pay the debt itself.[11] Congress used the words of Section 3672(a) in their "usual, conventional sense" (*United States v. Gilbert Associates*, 345 U.S. 361, 364 (1953)), and must have contemplated that the protection of a prior "mortgagee" extends to all the rights which mortgagees customarily enjoy. *United States v. Bond*, 279 F. 2d 837, 851 (4th Cir. 1960) (dissent), *cert. denied*, 364 U.S. 895 (1960). Under the terms of the prior mortgage, the mortgagee is to be made whole, free and clear of delinquent property taxes; and under the plain terms of Section 3672(a), the federal tax lien is not "valid" against the mort-

[11] Such a covenant was present in this case. (R. 33). Furthermore, the mortgage was entered into in reliance on the provisions of the New York statutes with respect to the payment of property taxes, which became as much a part of the mortgage contract as if expressed therein. *Brine v. Hartford Fire Insurance Co.*, 96 U.S. 627, 634 (1878).

gagee until the terms of the prior mortgage have been satisfied in that respect.

The fact that state laws almost universally prefer property taxes over all existing interests in the property means that instances of the bizarre and inequitable results above illustrated will be very frequent. In itself, the traditional priority of later property taxes is a bearable risk for the mortgagee, because such taxes typically bear a direct relation to the value of the property and ordinarily will be absorbed in the equity cushion. In contradistinction, federal taxes have no relation to the value of a particular property, and may well exceed the equity value. The potentiality that a mortgagor, within the life of the mortgage, may incur federal tax liabilities far in excess of the equity in the property thus creates new risks for even the seemingly best secured mortgagee. In *United States* v. *Brosnan*, 363 U.S. 237, 251-52 (1960), this Court weighed the desirability of uniformity of federal tax administration against the dislocations of long-established state procedures, and concluded that the avoidance of such dislocations was sufficient reason for permitting the procedural rules of state law to apply. Sustaining the mortgagee in the present case not only would avoid the dislocations in the mortgage market which the Government's position would produce, but—in view of the universality of the state rule preferring property taxes—would do so without sacrifice of uniformity.[12]

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[12] Unless the affirmance of the decision below were placed on the narrow ground that New York law calls the property taxes an expense of the foreclosure sale.

The Government suggests (Br. 24-25), by quotation from an article by Professor Seligson, that affirmance of the decision below would adversely affect the economy, by forcing the federal tax collector to foreclose tax liens immediately after they arise lest the Government suffer diminution of its interest through the accrual of subsequent property tax liens.[13] The harmful economic effects visualized as resulting from such prompt foreclosures would follow equally, however, if (as a result of reversal of the decision below) mortgagees are placed in a position where their own net recovery will be diminished by subsequent property taxes unless they declare a default as soon as such taxes become delinquent. The Government quotes Professor Seligson's statement that the mortgagee would be able to defer foreclosure by paying the accruing property taxes and adding them to the mortgage debt, "thus maintaining his priority over the tax lien"; but the Government fails to point out that such alternative is actually *denied* to the mortgagee by existing decisions. *United States* v. *Bond*, 279 F. 2d 837 (4th Cir. 1960), *cert. denied*, 364 U.S. 895 (1960); *United States* v. *Christenson*, 269 F. 2d 624 (9th Cir. 1959).

In any situation where the value of the property is insufficient to satisfy the aggregate amount of the mortgage, the federal lien and the property taxes, the party whose interest will be diminished by further property taxes—whether this Court determines that party to be the mortgagee or the Government—will be

[13] An identical pressure for prompt enforcement by the Government already exists in any event as a result of the never-questioned rule that mortgage interest, accruing after the federal tax lien is filed, enjoys the same priority as the principal of the mortgage and thus constantly diminishes the federal equity.

under pressure to foreclose as promptly as possible. The suggestion that the impact on the economy will be lessened by placing that burden on the mortgagee is, therefore, of doubtful validity. If the Government, as subordinate lienor, chooses to defer enforcement of its lien in the hope that continued operation of the taxpayer's business will ultimately result in greater collection, it should bear the risk that the expenses of that operation (including property taxes imposed for benefits conferred by state and local governments upon the property and the business) may exceed the gross earnings and thus impair the security; the Government should not expect a "free ride" at the expense of the prior mortgagee. *Cf. Borack* v. *City of New York*, 268 F. 2d 412, 416 (2d Cir. 1959).

III. Controlling Force of State Law

Some lawyers within the American Bar Association hold the view that priorities are a matter of property law, on which Congress and the federal courts must follow state laws and decisions.[14] Such view has not been considered by the Association, but the importance of the issue is felt to warrant the presentation of such view for the consideration of the Court.

This view is that the States never surrendered their sovereignty over the determination of substantive rights, including property rights. The States have the

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[14] Report of the Committee on Relative Priority of Government and Private Liens, Section of Real Property Probate and Trust Law (American Bar Association), Proceedings (1958) Part II, p. 81. Such report was not submitted to or passed upon by the House of Delegates or the Board of Governors, and hence is not to be deemed to represent the views of the Association. The Association's legislative proposals, *supra*, note 1, are premised on the belief that Congress may determine such matters.

power to give state and local taxes precedence over all other liens and rights (*International Harvester Credit Corp. v. Goodrich*, 350 U.S. 537 (1956)), and such rule has the force of a substantive rule of property. In *Erie Railroad Co. v. Tompkins*, 304 U.S. 64, 78 (1938), this Court declared that "Congress has no power to declare substantive rules of common law applicable in a State whether they be local in their nature or 'general,' be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts." The Court, quoting Mr. Justice Holmes, went on to say (p. 79) that "'the authority and only authority is the State, and if that be so, the voice adopted by the State as its own [whether it be of its Legislature or of its Supreme Court] should utter the last word.'"

Erie Railroad Co. v. Tompkins was a diversity case, but its application has not been confined to such cases. See *Continental Casualty Co. v. Schaefer*, 173 F.2d 5, 7 (9th Cir. 1949), *cert. denied*, 337 U.S. 940 and 338 U.S. 820 (1949). It does not appear that the possible application of its principle to matters of federal tax collection was argued in any of the long line of cases in this Court that applied a federal standard of "choateness" in denying priority to liens which would have enjoyed priority under state law. See, for example, *United States v. Acri*, 348 U.S. 211 (1955). On the other hand, in the first of the more recent series of cases which have stayed the hand of the tax collector, this Court did cite *Erie v. Tompkins*, although the decision was not placed upon constitutional grounds. *Commissioner v. Stern*, 357 U.S. 39, 45 (1958). The *Erie* case also was relied upon by the New York Court of Appeals in granting priority to the right of an at-

torney to share in a cause of action which had been partially assigned to him. *Matter of Washington Square Slum Clearance*, 5 N.Y. 2d 300, 314, 157 N.E. 2d 587, 595 (1959), *cert. denied sub nom. United States* v. *Coblentz*, 363 U.S. 841 (1960). But see *United States* v. *Christensen*, 269 F. 2d 624, 627 (9th Cir. 1959), and Article I, Section 8, Clause 1, Constitution of the United States.

In the companion cases of *Aquilino* v. *United States*, 363 U.S. 509 (1960), and *United States* v. *Durham Lumber Co.*, 363 U.S. 522 (1960), this Court applied the State law test in determining the priority of mechanics' liens and federal tax liens in the proceeds of construction contracts, and determined that the mechanic lienors should have priority where the property right of the taxpayers (defaulting contractors) was limited by state law to the residue after payment of claims. The Court narrowly distinguished earlier cases denying priority to mechanic lienors on the basis of a federal standard of choateness. Dissenting in the two cases, Mr. Justice Harlan (with the concurrence of Mr. Justice Black) declared (363 U.S. at 521) that "If the federal standard of choateness is thought to be an undesirable restriction on the States' freedom to regulate property relationships, the cases establishing that standard should be expressly overruled and not emasculated by dubious distinctions."

CONCLUSION

For the reasons stated, the judgment below should be affirmed. But, whether affirmed or reversed, a full opinion should be rendered, for the guidance of the

usiness community, the bar, the lower courts, and the
ongress.

Respectfully submitted,

FOR THE AMERICAN BAR ASSOCIATION

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October, 1962

SUPREME COURT, U. S.

OCT 17 1962

JOHN F. DAVIS, CLERK

IN THE

Supreme Court of the United States

October Term, 1962

No. 96

UNITED STATES OF AMERICA,

Petitioner,

v.

BUFFALO SAVINGS BANK.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF OF BUFFALO SAVINGS BANK

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INDEX

	PAGE
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes Involved	2
Statement	3
Summary of Argument	5
Argument	6
I. The Federal Tax Lien Attached to the Mortgaged Property Subject to the Right of the Mortgagee to Have Local Taxes Paid Out of the Mortgaged Property	6
II. The New Britain Case Does Not Apply Here	8
III. The Brosnan Case Does Apply	13
IV. The Crest Finance Co., Inc. Case Applies Here	15
V. The Affirmance of the New York Court of Appeals' Decision Would be in Accordance with the Intent of Congress When it Adopted Section 3672, Now 6323, Title 26 U. S. C.; and Section 2410, Title 28 U. S. C.	17
Conclusion	27
Appendix	28

CITATIONS

Cases:

Aquilino v. United States, 363 U. S. 509, 4 L. ed. 2d 1365	8, 22, Footnote 2—25, 27
Bank of America National Trust and Savings Association v. United States, 363 U. S. 237, 4 L. ed. 2d 1192	15
Brine v. The Hartford Fire Insurance Company, 96 U. S. 627	7

PAGE

PAGE

Brown v. General Laundry Service, Inc., 19 Conn. Supp. 335, 113 A. 2d 601 ..... 4, 9, 10, 11, 25
Central Surety and Insurance Corporation v. Martin Infante Co., Inc., 164 F. Supp. 923 23
Chase National Bank of City of New York v. Directorate General of Postal Remittances & Savings Bank, 95 F. Supp. 733 ..... Footnote 1—13
City of New York v. United States, 283 F. 2d 829 .. 22
Continental Casualty Co. v. Schaefer, 173 F. 2d 5 ..... Footnote 1—12
Crest Finance Co. Inc. v. United States, 368 U. S. 387, 7 L. ed. 2d 342 ..... 6, 15, 16
Erie Railroad Company v. Tompkins, 304 U. S. 64 ..... Footnote 1—12
Julia M. W. Gault v. Jason Bacon, 142 Conn. 200, 113 A. 2d 145 10
Guaranty Trust Co. v. York, 326 U. S. 99 .. Footnote 1—12, 13
Howard V. Hudson, 259 F. 2d 29 ..... Footnote 1—13
F. H. McGraw & Co., Inc. v. Sherman Plastering Co., Inc., 60 F. Supp. 304 23
Metropolitan Life Ins. Co. v. United States, 107 F. 2d 311 23
Ragen v. Merchants Transfer & Warehouse Company, 337 F. S. 530 ..... Footnote 1—13
Rahlin v. N. Y. Life Ins. Co., 304 U. S. 202 .. Footnote 1—12
United States v. Aeri, 348 U. S. 211 22
United States v. Boss, 357 U. S. 51, 2 L. ed. 2d 1135 .. 8
United States v. Bond, Fourth Circuit, 279 F. 2d 837 ..... 6, 19, 21, Footnote 2—25
United States v. Brosnan, 363 U. S. 237, 4 L. ed. 2d 1192 ..... 5, 13, 14, 15, 24, 27
United States v. Brosnan, 264 Fed. 2d 762 14
United States v. Christensen, Ninth Circuit, 269 F. 2d 624 ..... 21, Footnote 2—25
United States v. City of New Britain, 347 U. S. 81, 98 L. ed. 520 ..... 4, 5, 8, 11, 13, 15, 24, Footnote 2—25, 26, 27
United States v. Cox, 119 F. Supp. 147 23
United States v. Durham Lumber Co., 363 U. S. 522, 4 L. ed. 2d 1371 ..... 22, Footnote 2—25, 27

PAGE

United States v. Gilbert Associates Inc., 345 U. S. 361 22
United States v. Graham, 96 F. Supp. 318 23
United States v. Hutcherson, 188 F. 2d 326 23
United States v. Winnett, 165 F. 2d 149 23
Wichita Royalty Company v. City National Bank of Wichita Falls, 306 U. S. 103 ..... Footnote 1—12
Woods v. Interstate Realty Company, 337 U. S. 535 ..... Footnote 1—13

STATUTES:

Title 26 U. S. C. Section 3670, now 6321 ..... 2, 8, 17
Title 26 U. S. C. Section 3671, now 6322 2
Title 26 U. S. C. Section 3672 (a) (1), now 6323 (a) (1) 2, 6, 9, 17, 18, 21, 22
Title 28 U. S. C. Section 1444 ..... 3, 12
Title 28 U. S. C. Section 1652 ..... 3, 12, Footnote 1—12
Title 28 U. S. C. Section 2410 ..... 2, 3, 4, 5, 6, 12, 17, 18
New York Civil Practice Act, Section 1082 ..... 3, 7, 10, 11
New York Civil Practice Act, Section 1087 ..... 3, 4, 7, 11, 23, 24
New York Real Property Law, Section 240 (2) 3, 7
New York Real Property Law, Section 290 (3) 3, 7
New York Code of Civil Procedure 1626 ..... 3, 11
New York Code of Civil Procedure 1676 ..... 3, 11
Revised General Statutes of Connecticut, 1949, Sections 7208 and 7210, Title 58 ..... 3, 10

MISCELLANEOUS:

House of Representatives Report No. 1018, 62nd Congress, 2d Session, July 17, 1912 18
House of Representatives Report No. 95, 71st Congress, 2d Session, December 21, 1929 18

Supreme Court of the United States

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UNITED STATES OF AMERICA,

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v.

BUFFALO SAVINGS BANK.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK.

BRIEF OF BUFFALO SAVINGS BANK

Opinions Below

The first opinion of the Erie County Court is reported in 186 N. Y. S. 2d 960, 17 Misc. 2d 564 (Original 68, Print 37). The first opinion of the New York Supreme Court, Appellate Division, Fourth Department, is reported at 202 N. Y. S. 2d 70, 11 A. D. 2d 158 (Original 40, Print 19). The second opinion of the Erie County Court is reported at 206 N. Y. S. 2d 518, 26 Misc. 2d 443 (Original 29, Print 12). The second opinion of the New York Supreme Court, Appellate Division, Fourth Department, is reported at 215 N. Y. S. 2d 189, 13 A. D. 2d 207 (Original

115, Print 64). The opinion of the Court of Appeals of the State of New York is reported at 11 N. Y. 2d 31, 181 N. E. 2d 413 (Print 74).

Jurisdiction

The judgment of the Court of Appeals of the State of New York was entered February 22, 1962 (R. 91-92). The petition for a writ of certiorari was filed on April 30, 1962. The jurisdiction of this Court was invoked under 28 U. S. C. Section 1257 (3). Certiorari was granted June 11, 1962 (R. 93).

Questions Presented

Whether the United States, when it submits to the jurisdiction of a New York Court under the provisions of Title 28 U. S. C. 2410 (Appendix) in a mortgage foreclosure action, is bound by New York statutes as they define the mortgagee's interest in the mortgaged property after the execution of the mortgage as being subject to the right of the mortgagee to have real estate taxes and assessments paid out of the mortgaged property; and further whether it is bound by the provisions of the New York statutes which make real estate taxes and assessments paid by the referee expenses of sale, so that they are paid from the proceeds of the sale, before any amount thereof is paid either to the plaintiff mortgagee or to the United States on its tax lien; and further whether it is bound by the said statutes as they define surplus monies.

Statutes Involved

Sections 2670, 2671 and 2672 (a) (1) of Title 26 U. S. C., Internal Revenue Code. These sections were enacted imme-

terially by the 1954 Revenue Code and are now known as Sections 6321, 6322 and 6323 (a) (1), Title 26 U. S. C. Section 2410 of Title 28 U. S. C.; and Section 1444, Title 28 U. S. C.; and 1652 of Title 28 U. S. C.; Sections 1082 and 1087 of the New York Civil Practice Act; Sections 240 (2) and 290 (3) of the New York Real Property Law; Revised General Statutes of Connecticut, 1949, Sections 7208 and 7210, Title 58. In 1958 these sections were revised immaterially and are now known as Title 49, Chapter 846, Sections 49-25 and 49-29 General Statutes of Connecticut; and Sections 1626 and 1676 of the Code of Civil Procedure of the State of New York, predecessor to the New York Civil Practice Act, adopted by Chapter 178 of the Laws of 1880.

Statement

This is an action brought to foreclose a mortgage on real property. The mortgage was dated April 5, 1946, and recorded in Erie County Clerk's Office, New York, the same day (Original 58 and 61, Print 31 and 32). The United States of America was made a party defendant because of a tax lien which it filed in the Erie County Clerk's Office January 15, 1953 (Original 66, Print 36), subsequently to the date of the recording of plaintiff's mortgage (Original 61, Print 32). The United States was made a party defendant to this foreclosure action pursuant to the provisions of Section 2410, Title 28 U. S. C. (Appendix). None of the local municipal taxing authorities was a party to the action.

The Erie County Court made certain Findings of Fact and Conclusions of Law (Original 55, Print 29) and then on June 9, 1959, granted the first judgment of foreclosure and sale (Original 48, Print 24), which foreclosed the tax

lien of the United States from the mortgaged property, subject to the one year redemption period provided by 28 U. S. C. 2410 (c), and directed the referee appointed to conduct the foreclosure sale to sell the property subject to all unpaid real estate taxes and assessments pursuant to the provisions of Section 1087 of the New York Civil Practice Act (Appendix). On appeal, the New York Supreme Court, Appellate Division, Fourth Department, on July 1, 1960, reversed this judgment and remanded this case to the Erie County Court (Original 45, Print 23). Subsequently, a resettled judgment of foreclosure and sale was made by the Erie County Court on October 20, 1960 (Original 6, Print 3), which foreclosed the United States tax lien, subject to the one year redemption period provided for by 28 U. S. C. 2410 (c), and directed the referee appointed to conduct the foreclosure sale to pay the unpaid real estate taxes and assessments as expenses of the sale, pursuant to Section 1087 of the Civil Practice Act (Appendix). On appeal, the New York Supreme Court, Appellate Division, Fourth Department, by its order of May 18, 1961 (Original 108, Print 60), reversed the second judgment of the Erie County Court, dated October 20, 1960 (Original 6, Print 3), and directed that provisions should be inserted in the judgment providing that the referee appointed to sell the property bring the entire proceeds of the sale into court, and for the court to then order a distribution of such proceeds in the manner directed in the cases, United States vs. City of New Britain, 347 U. S. 81, 98 L. ed. 520, and Brown vs. General Laundry Service, 19 Conn. Supp. 335, 113 A. 2d 601. On appeal, the Court of Appeals, State of New York, by its order of February 22, 1962 (Print 91), reversed the order of the Appellate Division, dated May 18, 1961, and reinstated the judgment of the Erie County Court dated October 20, 1960 (Original

6, Print 3), which judgment provided for the payment of all real estate taxes and assessments as an expense of the sale before any moneys were allocated either to the plaintiff or the defendant, United States of America.

Summary of Argument

Buffalo Savings Bank adopts as a part of its argument all the reasoning contained in the majority opinion of the New York Court of Appeals.

This decision of the New York Court of Appeals is soundly based on two propositions, both recognized by this Court in previous cases.

The first of these is that after the execution of the mortgage, the mortgagor's ownership rights in the mortgaged premises, to which the federal tax lien attached, had been diminished by state law in that the mortgagee had a right to require that local real estate taxes and assessments be paid first from the proceeds of any foreclosure sale of the mortgaged property, and that the federal lien could only attach to such diminished property right of the taxpayer.

The second of these is that long-established New York mortgage foreclosure procedure making the payment of real estate taxes and assessments by a referee to sell on mortgage foreclosure an expense of the sale is binding on the United States when joined pursuant to 28 U. S. C. 2410 as a party defendant to cut off its tax lien.

U. S. v. City of New Britain, 347 U. S. 81, 98 L. ed. 520, is then distinguished and the applicability of U. S. v. Brosnan, 363 U. S. 237, 4 L. ed. 2d 1192, where this Court approved Pennsylvania mortgage foreclosure procedure which cut off the federal tax lien without payment and

provided for payment in full of real estate taxes and assessments is shown.

The relevance to this case of the Government's concession in Crest Finance Co. v. U. S., 368 U. S. 387, 7 L. ed. 2d 342, that the value of the property to which the federal lien attaches may vary in amount after the filing of the federal lien without affecting the choateness of the lien is shown. The intent of Congress when adopting 26 U. S. C. 3672 now 6323, which makes federal tax liens subordinate to prior recorded real estate mortgages and 28 U. S. C. 2410 which permits the joining of the United States as a party defendant to a state mortgage foreclosure action in order to cut off the federal tax lien, is shown by quotations from Congressional Reports at the time of their adoption.

Finally, the full rights of mortgagees as against subsequently filed federal tax liens is shown by a quotation from the dissenting opinion in U. S. v. Bond, Fourth Circuit, 279 F. 2d 827; and the narrowness of the issue in this case and how the New York Court of Appeals decision is not contrary to the holdings in any of the previous tax lien cases is shown.

POINT I

The federal tax lien attached to the mortgaged property subject to the right of the mortgagee to have local taxes paid out of the mortgaged property.

The mortgage involved in this action provided that "in case of default in the payment of the said sum of money, or of any part thereof, or the interest that might grow due thereon, or in the payment of taxes or assessments, the said plaintiff was thereby empowered to sell the said mortgaged premises according to law;" (Paragraph Fourth

Complaint: Original 80; Print 44-45; Erie County Court Decision, Finding of Fact 5; Original 60; Print 32). By statute in New York, a mortgage is defined as a conveyance. Real Property Law, Secs. 240 (2) and 290 (3) (Appendix). When the mortgagor executed the mortgage, he conveyed to the mortgagee the right, in the event of a default, to have the premises sold according to law. This law is found in Sections 1082 and 1087 of the New York Civil Practice Act (Appendix). Section 1082 of the New York Civil Practice Act states: that when a plaintiff in a foreclosure action becomes entitled to the final judgment "it must direct the sale of the property mortgaged or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale and the costs of the action" and Section 1087 of the New York Civil Practice Act directs the referee appointed to sell the foreclosed property to pay out of the proceeds of sale, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold * * * and states that "the sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article." These statutes were as much a part of the mortgage as though set forth in full therein. In Brine v. The Hartford Fire Insurance Company, 96 U. S. 627 (1878) this Court said at page 637:

> "All contracts between private parties are made with reference to the law of the place where they are made or are to be performed. Their construction, validity and effect are governed by the place where they are made and are to be performed if that be the same as it is in this case. It is, therefore, said that these laws enter into and become a part of the contract."

When the mortgagor herein executed his mortgage he thereby conveyed to the mortgagee the right to have any

unpaid local real estate taxes and assessments paid from the proceeds of a foreclosure sale of the mortgaged premises. By so doing he reduced his ownership rights in said mortgaged premises. When subsequently the federal tax lien was filed "the property and rights to property" belonging to him (26 U.S.C. 3670 now 6321 Appendix), had been reduced by the conveyance of this right to the mortgagee, and the federal tax lien attached only to this reduced ownership in the mortgaged property. Similar reductions by state law in the ownership rights of a taxpayer in his "property and rights to property" have been recognized by this Court as valid against a federal tax lien in U. S. v. Durham Lumber Co., 363 U. S. 522, 4 L. ed. 2d 1371; Aquilino v. U. S., 363 U. S. 509, 4 L. ed. 2d 1365; and U. S. v. Bess, 357 U. S. 51, 12 L. ed. 2d 1135.

POINT II

The New Britain case does not apply here.

The decision of the New York Court of Appeals in this case is not in conflict with the decision of this Court in the case of United States vs. City of New Britain, 347 U. S. 81, 98 L. ed. 520.

The New Britain case originated in the Superior Court of Hartford County, Connecticut, as a mortgage foreclosure action brought by Louis Brown against General Laundry Service, Inc. The action proceeded in the usual way until following the sale of the mortgaged premises a supplementary judgment was entered December 19, 1951, which directed payment from the proceeds of sale in the following order: the expenses of the sale, the taxes due the City of New Britain in full, the full amount due the mortgagee, Louis Brown, the full amount due William G. Dunn, a

judgment creditor whose judgment was docketed subsequently to the recording of the mortgages but prior to the filing of the federal tax liens, and lastly, the balance to the United States of America to apply on its tax lien. The United States of America appealed to the Supreme Court of Errors of the State of Connecticut, and the City of New Britain, which had not up to this point been a party to the action, intervened to contest the appeal. The sole question raised in the Supreme Court of Errors was as to the relative priority of the lien of the taxes due the City of New Britain and the lien of the federal taxes, and the only parties who appeared on the appeal were the City of New Britain and the United States of America. The Supreme Court of Errors of the State of Connecticut affirmed the judgment of the Superior Court of Hartford County. The United States of America then petitioned this Court for certiorari, which was granted. The sole question raised in this Court was again the same relative priority of municipal and federal tax liens and again the only parties present were the City of New Britain and the United States of America. The mortgagee and the judgment creditor took no part in the proceedings in either court, and thus were not present to object to any form of judgment which might purport to give effectual priority to the federal liens over the mortgagee and judgment creditor contrary to the provisions of Section 3672 now 6323, of Title 26 U. S. C. (Appendix).

It was not until the case went back to the Superior Court of Hartford County, on remand from this Court, as Brown vs. General Laundry Service, Inc., 19 Conn. Sup. 335, 113 A. 2d 601, that the question of "circular priority" entered the case to reduce the amount previously set aside for the judgment creditor, William G. Dunn, in order to pay in

full the federal tax lien. This was not because this Court had directed any such reduction. It was because the Connecticut Court held that Connecticut foreclosure procedure required such a reduction in order to comply with the decision of this Court. New York foreclosure procedure does not require the same result.

Mortgage foreclosure procedure in Connecticut differs from that in New York in that in Connecticut the entire proceeds of a foreclosure sale are brought into Court and thereafter a supplemental judgment is rendered, specifying the parties who are entitled thereto and the amount to which each, including the plaintiff, is entitled. Sections 7208 and 7210, Title 58, Revised General Statutes of Connecticut, 1949, predecessor to 49 Conn. Gen. Statutes, Chapter 846, Secs. 49-27, 49-29, revised 1958 (Appendix). In Julia M. W. Gault vs. Jason Bacon, 142 Conn. 200, 113 A. 2d 145, it is stated:

> "The decree of foreclosure by sale should not adjudicate the rights of the parties to the funds realized; those rights should be determined by way of a supplemental judgment. City National Bank vs. Stoeckel, 102 Conn. 732, 744; 132 A. 20."

In Connecticut, this supplemental judgment directs the payment of local taxes from the proceeds of sale at the same time it adjudicates the rights of the parties including the plaintiff and all defendants in the same proceeds of sale. Brown v. General Laundry Service, Inc., 79 Conn. Sup. 235, 113 A. 2d 601.

New York procedure is different. There Section 1082 of the Civil Practice Act provides for a sale of the mortgaged property, or so much thereof as is necessary to discharge the mortgage debt, the expenses of sale, and the costs of the action, and directs that all surplus moneys arising from the sale shall then be deposited within five

days after the sale subject to the further order of the Court; and Section 1087 of the Civil Practice Act defines as an expense of the sale the payment of taxes, assessments and water rates which are liens on the mortgaged property or the payment of such sums as are necessary to redeem the property sold from any sale for the unpaid taxes, assessments or water rates, and provides that the Court shall direct the referee to pay said taxes; unless, the Court, in its discretion, directs that said property be sold subject to said taxes.

In Connecticut the real estate taxes and assessments are paid because they are liens on the mortgaged property, while in New York they are paid as expenses of the foreclosure sale. There is nothing in U. S. v. City of New Britain which prohibits the payment of expenses of sale before the federal lien. Brown v. General Laundry Service, 19 Conn. Supp. 335, 113 A. 2d 601, recognized that expenses of sale had priority when it directed their payment prior to the payment of any moneys to the City of New Britain, the United States or to the plaintiff, Louis Brown.

This New York practice far antedates any federal tax lien statutes and questions arising therefrom. Section 1082 of the New York Civil Practice Act is derived from Section 1626 of the New York Code of Civil Procedure adopted by Chapter 522 of the Laws of New York of 1880, and Section 1087 is derived from Section 1676 of the Code of Civil Procedure adopted by Chapter 522 of the Laws of New York of 1880. Sections 1626 and 1676 of said Civil Code of Procedure, as adopted in 1880, are set forth in the Appendix.

As the New York Court of Appeals stated, the local taxing authorities in this case are not competing with the

United States for payment from the same fund. No question of "circular priority" arises. The local taxes will be paid as an expense of sale before the surplus from which the United States lien must be paid is created. The United States is bound by this procedure when joined as a party defendant in a foreclosure action in a New York state court by virtue of the provisions of Section 2410 U. S. C. 28 (Appendix). It would be equally bound by the same procedure by virtue of Section 1652 U. S. C. 28 (Appendix) if it removed the state court case to the federal district court pursuant to Section 1444 U. S. C. 28 (Appendix).[1]

[1] Prior to the decision in Erie Railroad Company vs. Tompkins, 304 U. S. 64 (1938), Section 1652 Title 28 U. S. C. was held to apply only to the statute laws of the several states. Mr. Justice Brandeis in that case stated: "Third. Except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State. And whether the law of the State shall be declared by its Legislature in a statute or by its highest court in a decision is not a matter of federal concern. There is no federal general common law. Congress has no power to declare substantive rules of common law applicable in a State whether they be local in their nature or 'general', be they commercial law or a part of the law of torts. And no clause in the Constitution purports to confer such a power upon the federal courts."

The principle of Erie Railroad Company v. Tompkins, 304 U. S. 64, an action at law, was applied to a suit in equity in Ruhlin v. N. Y. Life Ins. Co., 304 U. S. 202.

In the early cases after Erie Railroad Company vs. Tompkins, the rule was applied only to substantive law. Guaranty Trust Co. vs. York, 326 U. S. 99 (1945), removed that distinction. Since Guaranty Trust Company vs. York *supra*, the distinguishing point is not whether the state law relates to practice or substantive law. The important point is that if the state law, be it practice or substantive law, is not applied in a federal court, a different result will ensue in the federal court sitting across the street from the state court.

While the opinion in the Guaranty Trust Co. case discusses the applicability of this rule in diversity of citizenship cases, the courts have not confined the rule to diversity of citizenship cases.

In Wichita Royalty Company vs. City National Bank of Wichita Falls, 306 U. S. 103, it was applied in a case removed from a Texas State Court to a federal district court. Mr. Justice Stone in that case stated: "In departing from the law of the case, as announced by the state court, and applying a different rule, the court below correctly stated that by reason of the removal it had been substituted for the Texas Supreme Court as the appropriate court of appeal and that it was its duty to apply the Texas law as the Texas court would have declared and applied it on a second appeal if the cause had not been removed. It was the duty of the federal court to apply the law of Texas as declared by its highest court. Erie R. Co. v. Tompkins, 304 U. S. 64, 82 L. ed. 1188, 58 S. Ct. 817, 114 A. L. R. 1487, *supra*."

In Continental Casualty Co. v. Schaefer, 173 F. 2d 5 (1949) it was applied when federal jurisdiction was conferred by the Miller Act.

(Footnote continued on following page)

POINT III

The Brosnan case does apply.

Since the mortgagee and judgment creditor were not parties to the New Britain case in the Supreme Court and only the City of New Britain and the Government were present, all statements in that case which would suggest that local taxes must come out of the mortgagee's share are *obiter dicta* contrary to the later direct holding by this Court in U. S. v. Brosnan, 363 U. S. 237, 4 L. ed. 2d 1192, that local taxes can be paid in a foreclosure action as an expense of the sale.

New York and Connecticut foreclosure procedure not only differ from each other, but also differ from Pennsylvania foreclosure procedure, as described and approved of by this Court in United States vs. Brosnan, 363 U. S. 237, 4 L. ed. 2d 1192. However, New York and Pennsylvania procedures have one thing in common, *i.e.*, the United States tax lien is foreclosed and divested from the mortgaged property without any payment of the federal lien, in a judicial foreclosure action which also provides the payment in full of local taxes and assessments as a part of the foreclosure action. This fact was brought

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(Footnote continued from preceding page)

In Chase National Bank of City of New York vs. Directorate General of Postal Remittances & Savings Bank, 95 F. Supp. 733, in 1951, it was applied in a case removed from the state court to the federal district court because one of the parties was a national bank.

In Howard vs. Hudson, 259 F. 2d 29 (1958), it was applied in a case removed to a federal court because a defendant was an officer of an agency of the United States.

The holding in Guaranty Trust Co. vs. York, 326 U. S. 99, that the Erie R. Co. vs. Tompkins rule applied to the adjective as well as substantive law has been applied in a number of cases. In Ragen vs. Merchants Transfer & Warehouse Company, 337 U. S. 530 (1949), a state statute of limitation was applied. In Woods vs. Interstate Realty Company, 337 U. S. 535 (1949), the suit in the federal court was dismissed because the foreign corporation had not complied with the state law requiring it to designate an agent on whom service of process could be made.

to this Court's attention in the Government's brief in the Brosnan case. The pertinent portion of the Government's brief is quoted at length in the majority opinion of the New York Court of Appeals, 11 N. Y. 2d 31, 41 (Print 80-1), as follows:

> "Indeed, Pennsylvania law itself treats state tax liens more favorably than federal tax liens. A Pennsylvania statute provides that 'The lien of all taxes * * * against any real estate within this Commonwealth shall be divested by any judicial sale of such land: Provided, The amount of the purchase money shall equal the amount of the said taxes' (Purdon's Penna. Statutes Annotated, Title 53, Section 7104, Appendix, *infra*, page 36). While Pennsylvania law permits discharge of a junior lien on realty through foreclosure of a prior mortgage at a sheriff's sale, the Commonwealth's liens may be divested only to the extent permitted by statute (cases cited). Thus, under Pennsylvania law the state's tax lien will be discharged through foreclosure only if the state's tax claim is paid in full out of the proceedings. The decision below holds, however, that the same foreclosure proceeding wipes out the federal lien even though the United States received not a single penny toward payment of its claim."

The fact was also mentioned in the opinion of the Circuit Court of Appeals in the Brosnan case, 264 Fed. 2d 762, where at page 764 the following statement appears: "The amount of the bid went to satisfy costs of the sale, and for various outstanding local taxes." Yet with knowledge of this fact, this Court did not consider it a sufficiently valid objection to Pennsylvania mortgage foreclosure procedure to merit mention of it in its opinion. Judge Fuld's statement in the dissenting opinion in the New York Court of Appeals, 11 N. Y. 2d 31, 50 (Print 89-90): "In the second place, although local taxes had been paid out of the proceeds of the mortgage sale and thus had, in effect, achieved priority, that issue was never raised on

appeal * * * is erroneous if by it he meant it was not called to this Court's attention, and unconvincing if he meant it was not made a point of argument by the Government. Since the payment of local property taxes from the proceeds of sale is such an integral, inseparable, and important feature of Pennsylvania foreclosure procedure, it is inconceivable that this Court did not give it due consideration in reaching its decision.

This Court did say in the Brosnan case, 363 U. S. 237, at page 242: "We believe that, so far as this Court is concerned, the need for uniformity (in the collection of federal taxes) in this instance is outweighed by the severe dislocation to local property relationships which would result from our disregarding state procedures." The application of the dicta in the New Britain case which the Government claims to exist and asks to have applied here, would severely upset long established property rights in New York State, and put New York mortgagees in a less advantageous position than their counterparts in Pennsylvania and in those states which permit non-judicial foreclosures (Bank of America National Trust and Savings Association v. United States, 363 U. S. 237, 4 L. ed. 1192) since New York mortgagees, through the "circular priority" theory advanced by the Government here, would have to pay local taxes from their share of the sale proceeds.

POINT IV

The Crest Finance Co., Inc. case applies here.

In Crest Finance Co., Inc. vs. United States, 368 U. S. 387, 7 L. ed. 2d 342, this Court stated that in view of the Solicitor General's concession that petitioner's lien was choate, and the Court agreeing therewith, certiorari was

contract and the judgment vacated. The question involved in the Crest Finance Co., Inc. case was whether the lien competing with the federal tax lien was choate because the property to which the lien attached was not definite. There the Government's brief states that Crest Finance Co., Inc. and the United States were claimants to a fund owed by Standard to the Twin Excavating Company, Inc. and the facts are as follows at pages 2 and 3:

> "Standard was the prime contractor for the construction of a certain portion of the Illinois Toll Road in the neighborhood of Harvey, Illinois. On September 20, 1956, the taxpayer entered into a subcontract with Standard for hauling and compacting excavated dirt. Under the terms of the contract, Standard agreed to make progress payments to the taxpayer for work performed, based upon estimates covered by weekly reports or invoices, predicated on a count of the number of loads of fill carried to the site of the construction. All the invoices contained the statement that the estimates were subject to revision as to the actual amounts by the project engineer. (R. 20.)
>
> "From March 21, 1958, through June 10, 1958, the petitioner made nine loans to the taxpayer totaling $[illegible]. The loans were evidenced by the taxpayer's note and were secured by concurrent assignments of the taxpayer's right to payment from Standard for the work performed up to the date of each assignment as estimated by the weekly invoices."

The applicability of the Crest Finance case to our case is stated precisely in the Government's memorandum at page 6:

> "That the amount owing to the taxpayer by Standard for the work performed was, at the date of the tax assessments, still subject to final computation and to minor changes that were believed, affect the definiteness or specificity of the petitioner's lien. The property subject to the lien was the specific right to payment for work performed, and the indefiniteness of the amount due for that work goes only to the definiteness

of the lien (which was for the liquidated amount of the notes evidencing the loans from petitioner to the taxpayer), but to the value of the property subject to the lien. *Just as a mortgage on real estate is not made inchoate because the value of the property covered the mortgagor's title to it is uncertain, so the petitioner's lien on the taxpayer's contractual right to payment for work performed is not made inchoate because the amount payable on the assigned right has not been finally ascertained. The requirement of definiteness of amount goes only to the debt secured by the lien, not to the property (otherwise specifically identified) that is subject to the lien.*" (Emphasis Supplied)

From this concession, it follows that there can be no objection in this case to the fact that the mortgagor's equity in the mortgaged premises varies in value, by decreasing as real estate taxes and assessments are levied against the mortgaged property, pursuant to an established tax rate, after the filing of the federal lien.

POINT V

The affirmance of the New York Court of Appeals Decision would be in accordance with the intent of Congress when it adopted Section 3672, now 6323, Title 26 U. S. C.; and Section 2410, Title 28 U. S. C.

Section 3672, now 6323, Title 26 U. S. C. (Appendix), provides that the federal tax lien imposed by Section 3670, now 6321, Title 26, shall not be valid against any mortgagee, * * * until notice thereof has been filed by the Secretary or his delegate. It is this Section which makes Buffalo Savings Bank's mortgage, recorded prior to the filing of the federal tax lien in this action, a prior lien to the federal tax lien. Section 2410, Title 28, U. S. C. (Appendix), is the enabling statute by which Buffalo Savings

Bank was permitted to join the United States as a party defendant in this foreclosure action for the purpose of cutting off this federal tax lien. The predecessor to Section 3672 now 6323, was enacted by Congress in 1913. The House of Representatives Report on this bill No. 1018, 62nd Congress, 2d Session; July 17, 1912 (Appendix), contains the statement in the second last paragraph: "There is no reason why the Government should not occupy the same position with reference to liens on property as does the individual."

At the time the predecessor to the present Section 2410, U. S. C. 28, was adopted, House of Representatives Report on this bill No. 95, 71st Congress, 2d Session, dated December 21, 1929, stated at the bottom of the third paragraph that this Section was enacted because of the then existing situation where "He (the mortgagee) is, therefore, in effect defeated of his own right to foreclose unless he is willing to pay off the Government lien; a debt for which he is in no way responsible and he being a person to whom the Government would in no event look for its payment."

Despite these expressions of Congressional intent the Government in this case asks that its tax lien be given better treatment than the lien of an individual and definitely seeks to collect its tax from one (the mortgagee) who does not owe it.

It should be noted that Section 3672 now 6323, does not state that the federal lien shall not be valid as against any *mortgage* until filed as therein provided, but says such lien shall not be valid as against any *mortgagee* "until notice thereof has been filed as therein provided." It is the *mortgagee* that Congress intended to protect and not the

mortgage. Circuit Judge Haynsworth in his dissenting opinion in the case of U. S. vs. Bond, 279 F. 2d 837 (May 31, 1960) at pages 851 and 852, although he is discussing the right of a mortgagee to advance money to pay taxes and add the amount advanced to the principal of its mortgage, nevertheless has some interesting observations on Congressional intent on adopting this statute, and on the distinction in the use of the word *mortgagee* rather than *mortgage* when he says:

> "If the decision in Ball Construction has not foreclosed the present question, and it seems to me far from certain that it has, it is incumbent upon us to focus our attention upon the statute which confers a preference upon a 'mortgagee' and to inquire whether the statute should be so construed as to withhold preferential treatment from one, indisputably a mortgagee, to the extent the mortgage debt is uncertain in amount or not fully accrued when the tax lien is recorded.
>
> "This, the crucial question, need not detain us long. If our view of the statute be not obscured by rules developed for the deferment of unpreferred interests, it seems clear that the words of the statute were used in their 'usual, conventional sense.' (U. S. vs. Gilbert Associates, Inc., 345 U. S. 361, 97 L. ed. 1071). The Congress did not prefer the principal of the mortgage debt; it preferred the mortgagee. If the word is to be given its usual meaning the preference cannot be limited to the mortgagee's right to repayment of the principal of the mortgage debt. It extends to all those rights which the Congress must have known the mortgagee commonly and usually possesses.
>
> "Provisions in mortgages requiring or permitting the mortgagee to discharge ad valorem tax liens and extending the mortgage lien to such disbursements, as well as to the expense of enforcement of the mortgagee's rights, are commonplace. There is nothing novel in recognition of the fact that the protection of the mortgage lien extends to such disbursements and

expenses, made pursuant to such provisions, as fully as to the principal of the mortgage debt itself. It is a usual and conventional right of a mortgagee. When Congress created the preference, such rights of the mortgagee were generally recognized in commerce and in law. If we are to give the language of the statute its usual and ordinary meaning, we cannot deny to the mortgagee his usual and ordinary rights. Since the statute confers the preference upon the mortgagee, it seems to require us to recognize the preference, at the least, to the extent that his preference has been traditionally and commonly recognized in the state courts. I see no reason to suppose that Congress intended the preference it commanded to differ in kind and quality from the preference the selected classes have enjoyed historically and, in commercial circles, are generally thought to have.

"While the question is novel in this court, and, I believe, open in the Supreme Court, there are analogies that bear mention.

"A mortgagee's collection out of the security of attorney's fees incurred after the mortgagor's adjudication in bankruptcy was resisted upon the ground that the claim was contingent at the time of adjudication and, therefore, not provable. The Supreme Court held there was no need to prove the claim for the right to attorney's fees was fully protected by the mortgage lien from the time that lien first attached. (Security Mortgage Co. v. Powers, 278 U. S. 149, 73 L. ed. 236.) In the opinion it was said, 'The lien was not inchoate at the time of the adjudication.'

"This Court dealt with a similar problem when attorney's fees were incurred by a mortgagee after forfeiture of the mortgaged vehicle to the United States. (United States v. Seaboard Citizens Nat'l Bank of Norfolk, 4 Cir., 206 F. 2d 62.) We held the right to attorney's fees fully protected from the date the mortgage lien attached, saying, 'The lien for attorney's fees was not inchoate at the time of the offense.'

"As the rules have been developed in the tax lien cases, the claim for attorney's fees was inchoate when

the tax lien attached. Perhaps we may say as the Supreme Court said in the bankruptcy case that the lien which supports the claim was not inchoate. Whether we do or not, we should reach a similar result here, for no valid reason appears for reading limitations into the preference statute which the language of the statute does not contemplate.

"The specific question has arisen in other courts.

"The mortgagee has been held preferred with respect to attorney's fees and similar expenses incurred after the tax lien was recorded (U. S. v. Halton Tractor Co., 9 Cir., 258 F. 2d 612) and with respect to state taxes paid by the mortgagee. The mortgagee's preference with respect to accruing interest has been generally recognized. (U. S. v. Halton Tractor Co., 9 Cir., 258 F. 2d 612.) Perhaps the right to interest accruing at an agreed rate could pass the inchoate test, *but to a substantive recognition of the mortgagee's preference, his right to be secure in his income is hardly so important as his right to be secure in making disbursements necessary for the protection or preservation of the mortgage lien and for the collection of the principal of the mortgage debt.*" (Emphasis Supplied.)

Buffalo Savings Bank agrees with all of Judge Haynsworth's interpretations of the intent of Congress in enacting this Section (3672 now 6323, Title 26 U. S. C.). However, it is not necessary for this Court to adopt all of them in order for it to affirm the New York Court of Appeals' judgment in this case.

All Buffalo Savings Bank seeks to recover here is the unpaid balance of the original principal sum of its mortgage. It did not advance any money for taxes which it seeks to add to the principal of its mortgage. For that reason, U. S. vs. Bond, Fourth Circuit, 279 F. 2d 837, and U. S. vs. Christensen, Ninth Circuit, 269 F. 2d 624, cited in Judge Fuld's dissenting opinion have no application here

because they deal with the inchoateness of claims for tax advances after the filing of the federal tax lien.

There is no dispute here about Buffalo Savings Bank's mortgage being a valid mortgage recorded prior to the filing of the federal tax lien. For that reason, U. S. vs. Gilbert Associates Inc., 345 U. S. 361, and U. S. vs. Acri, 348 U. S. 211, dealing with state attempts to label as a mortgage or judgment a lien not a true mortgage or judgment so that it will come within the provisions of 3672, now 6323, U. S. C., 26 have no application here.

Some statements in the Government's Brief must be challenged. One is on page 7 thereof as follows: "It is the New York Court of Appeals' position that the State tax liens attach directly to this property while the federal tax lien attaches only to the taxpayer's interest in the property. But this distinction is directly contrary to the settled decisions of this Court. The law established by this Court holds that the federal tax lien attaches to the property itself, exactly as a state tax lien (*e.g.*, Michigan v. United States, 317 U. S. 338) and take priority over all subsequently attaching liens." Michigan v. United States does not so hold. All it says is that when a federal tax lien has attached to property it cannot be displaced by a subsequent lien made prior by state law. Aquilino v. U. S. (*supra*) and U. S. v. Durham Lumber Co. (*supra*) specifically held that the federal tax lien attaches only to the taxpayer's interest in the property.

In City of New York v. United States, 283 F. 2d 829 (1960), Chief Judge Lumbard at page 832 states:

> "The Section 6321 lien attaches only to the extent of the taxpayer's property interest, United States v. Bess, 357 U. S., 1958, 175 F. 2d 196, and is not a proper basis for a lien on contingent rights before they come

into being. United States v. Long Island Drug Co., 2 Cir., 1940, 115 F. 2d 983. Thus, the property, after it had been assigned by the taxpayer, could not be subjected to the government's lien."

In Metropolitan Life Ins. Co. v. United States, 107 F. 2d 311, Sixth Circuit (1939), Cert. denied 310 U. S. 630, Circuit Judge Arant in his dissenting opinion at page 314 states:

"The lien of the United States involved herein was based upon an income tax, not a property tax, and attached only to 'property and rights to property, whether real or personal, belonging to' the tax debtor. R. S. Sec. 3186, U. S. C., title 26, Sec. 1560, 26 U. S. C. A. Section 1560."

In United States v. Cox, 119 F. Supp. 147, District Court, Northern District of Georgia (1953), at page 151, District Judge Sloan stated:

"The lien of the government attached to all of the property in possession of the taxpayer to the extent of his interest and right thereto. (Metropolitan Life Ins. Co. v. U. S., 6 Cir., 107 F. 2d 311, 313.)"

In United States v. Winnett, 165 F. 2d 149, at page 151, Circuit Judge Orr stated:

"* * * the rights of the Collector do not extend beyond those of the taxpayer whose right to property is sought to be levied upon."

To the same effect are F. H. McGraw & Co., Inc. v. Sherman Plastering Co., Inc., 60 F. Supp. 504 (1943), affirmed 149 F. 2d 301, Cert. denied 326 U. S. 753; United States v. Hutcherson, 188 F. 2d 326; Central Surety and Insurance Corporation v. Martin Infante Co., Inc., 164 F. Supp. 923, affirmed 272 F. 2d 231; and United States v. Graham, 96 F. Supp. 318 (1951), affirmed 243 F. 2d 919.

The statement on page 23, "Sections 1082 and 1087 of the New York Civil Practice Act do not establish pro-

cedures for the divestiture of liens or for any other purpose. They deal with the order of payment of claims, a substantive matter of priorities which Brosnan makes clear is governed not by state law but by Section 3670 as interpreted in New Britain, 363 U. S. at 240-244." is refuted by the Brosnan case itself. The provision for the payment of real estate taxes from the foreclosure sale proceeds is set forth in the Pennsylvania statutes cited in the Government's Brief in Brosnan (R. 81), but as the payment thereof from the sale proceeds is set forth in Section 1087 of the New York Civil Practice Act. If such direction for payment was deemed procedural in Pennsylvania practice, it follows it must be procedural and not substantive in New York practice.

The comment on page 9 brings in extraneous matter when it says, "There is no showing here that the federal lien so established has overburdened either municipalities or mortgagees." It is true the Record in this case does not show it, but the statement is hardly justified by the facts. In every mortgage foreclosure in New York State where there was a federal tax lien on the mortgaged property filed subsequently to the recording of the mortgage, the Government has sought to have its tax lien paid at the expense of the mortgagee under its theory of "circular priority". There are literally hundreds, if not thousands, of these cases, and they have indeed overburdened mortgagees and have given municipalities nothing they would not otherwise have had. The effect of this has been to encourage mortgagees to immediately institute foreclosure proceedings on a default, when sometimes some delay would have permitted the mortgagor to re-establish himself and save his home.

Unless this Court, at this time, wishes to expressly reverse them, all [redacted] cases cited by the Government, includ-

ing the New Britain case, will remain undisturbed by an affirmance of the New York Court of Appeals judgment in this case.[1] The principle of first in time, first in right; and the superiority of federal tax liens over state levied taxes will remain undisturbed.

The Government's argument here is based on an interence drawn from this Court's opinion in the New Britain case and not on any express statement in that opinion. All this Court said there was, "The United States is not interested in whether the State recovers its taxes and water rents prior to mortgagees and judgment creditors. That is a matter of state law. But as to any funds in excess of the amount necessary to pay the mortgagee and judgment creditors Congress intended to assert the federal lien." It was the Connecticut Court on remand (Brown vs. General Laundry Service, Inc., 19 Conn. Supp. 335, 113 A. 2d 601) which said Connecticut foreclosure procedure re-

[1] Buffalo Savings Bank has chosen to argue this case without challenging the essential principle enunciated in U. S. vs. City of New Britain *supra*, on the reason that it believes the contractual right given it by the mortgage to have the real property taxes paid from the proceeds of a foreclosure sale, and New York foreclosure procedure either directing a sale subject to the local real estate taxes, or requiring the payment of the local real-estate taxes as an expense of the sale, are ample grounds for an affirmance by this Court of the New York Court of Appeals judgment.

However, it can be argued that since this Court in Aquilino vs. U. S., 363 U. S. 509, and U. S. vs. Durham Lumber Co., 363 U. S. 522 has recognized the right of a state by statute to diminish the ownership rights of a taxpayer in real property so that the federal tax lien attaches only to the diminished ownership, it follows that this Court should recognize the right of a state by statute to authorize the annual levying of real estate taxes and assessments to cover the cost of essential services to protect and maintain the real property, which as they are levied diminish the ownership rights of the taxpayer. (These statutes are set forth in Appendix to the Brief of the United States.) The ownership rights are so diminished by the taxes that the owner can only convey his interest in the property subject to their burden regardless of whether there is a mortgage or a federal tax lien on the property. Such recognition would, of course, amount to a repudiation of the New Britain doctrine.

Also, once this principle is recognized the basis for the decisions in U. S. vs. Reed, 270 F. 2d 837, and U. S. vs. Christensen, 269 F. 2d 624, is removed and the right of the mortgagee, after the filing of a federal tax lien, to advance money to pay taxes and add the amount of the advance to his mortgage debt is restored.

Such an interpretation would also assure mutuality of the rights of mortgagees in all of the states.

quired that the state taxes be paid from the sale proceeds, and reduced the share of the judgment creditor in said proceeds so that the federal lien and the state taxes could both be paid in full. If Connecticut mortgage foreclosure procedure had permitted it to do so, the Connecticut court on remand would have complied with this Court's directions if it had ordered that the mortgagee and judgment creditor be paid in full but that no part of the sale proceeds be used to pay municipal taxes until the federal lien was paid in full. Under this procedure the City would still have received its tax money, because the purchaser, after the sale was completed, would have had to pay these taxes if he wanted to avoid losing the property through a subsequent tax foreclosure.

Since New York procedure does not require that state taxes be paid from the sale proceeds, but permits a foreclosure sale subject to real estate taxes, the first judgment of the Erie County Court of June 9, 1959, so directing (Original 48, Print 24) was a proper one not at variance with the New Britain doctrine. The Appellate Division, Fourth Department, adopted the Government's erroneous inference when by its order of July 1, 1960 (Original 45, Print 23), it reversed this judgment because as it said (Original 42, Print 20): "The amount realized upon the sale would undoubtedly reflect the fact that the property had been sold subject to the lien of the local taxes and the proceeds of the sale available for the payment of all other liens, including the federal tax lien, would be accordingly reduced."

Since in granting certiorari, this Court has taken the whole case for consideration, Buffalo Savings Bank respectfully requests it to pass on the propriety of this first judgment of June 9, 1959.

It is Buffalo Savings Bank's contention that the proper interpretation to be given New Britain is that when competing for payment from the same fund at the same time, the federal lien must be paid before state taxes. This logical interpretation would then permit a foreclosure sale subject to real estate taxes, or permit the real estate taxes to be paid as an expense of the sale, when state foreclosure procedure does not prohibit it. It gives the federal tax lien priority over state taxes without subordinating the mortgage to the federal lien contrary to the expressed intention of Congress.

This Court in affirming the New York Court of Appeals judgment will merely be reaffirming the right of a state to define the property interest to which federal tax liens attach. Aquilino vs. U. S. (*supra*). U. S. vs. Durham Lumber Co. (*supra*), and acknowledging that New York State foreclosure procedure is equally binding on the United States as Pennsylvania foreclosure procedure. U. S. vs. Brosnan (*supra*).

CONCLUSION

The judgment of the New York Court of Appeals should be affirmed.

Respectfully submitted,

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Buffalo 3, New York

APPENDIX

Title 26 United States Code, 1939 Code

SEC. 3670. PROPERTY SUBJECT TO LIEN.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, penalty, additional amount, or addition to such tax, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 3671. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien shall arise at the time the assessment list was received by the collector and shall continue until the liability for such amount is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 3672. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) Invalidity of Lien without Notice.—Such lien shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the collector—

(1) Under State or Territorial laws.—In the office in which the filing of such notice is authorized by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law authorized the filing of such notice in an office within the State or Territory;

Appendix

Title 26 United States Code: 1954 Code. —

SEC. 6321. LIEN FOR TAXES

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) Invalidity of lien without notice. Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) Under state or territorial laws. In the office designated by the law of the State or Territory in which the property subject to the lien is situated.

whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

Title 28 United States Code:

Sec. 1441. Removal of Actions Against United States

Any action brought under section 2410 of this title against the United States in any State court may be removed by the United States to the district court of the United States for the district and division in which the action is pending.

Title 28 United States Code:

Sec. 1652. State Laws as Rules of Decision

The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.

Title 28 United States Code:

Sec. 2410. Actions Affecting Property on Which United States Has Lien

(a) Under the conditions prescribed in this section and section 1444 of this title for the protection of the

United States, the United States may be named a party in any civil action or suit in any district court, or in any State court having jurisdiction of the subject matter, to quiet title to or for the foreclosure of a mortgage or other lien upon real or personal property on which the United States has or claims a mortgage or other lien.

(b) The complaint shall set forth with particularity the nature of the interest or lien of the United States. In actions in the State courts service upon the United States shall be made by serving the process of the court with a copy of the complaint upon the United States attorney for the district in which the action is brought or upon an assistant United States attorney or clerical employee designated by the United States attorney in writing filed with the clerk of the court in which the action is brought and by sending copies of the process and complaint, by registered mail, or by certified mail, to the Attorney General of the United States at Washington, District of Columbia. In such actions the United States may appear and answer, plead or demur within sixty days after such service or such further time as the court may allow.

(c) A judicial sale in such action or suit shall have the same effect respecting the discharge of the property from liens and encumbrances held by the United States as may be provided with respect to such matters by the local law of the place where the property is situated. A sale to satisfy a lien inferior to one of the United States, shall be made subject to and without disturbing the lien of the United States.

unless the United States consents that the property may be sold free of its lien and the proceeds divided as the parties may be entitled. Where a sale of real estate is made to satisfy a lien prior to that of the United States, the United States shall have one year from the date of sale within which to redeem. In any case where the debt owing the United States is due, the United States may ask, by way of affirmative relief, for the foreclosure of its own lien and where property is sold to satisfy a first lien held by the United States, the United States may bid at the sale such sum, not exceeding the amount of its claim with expenses of sale, as may be directed by the head of the department or agency of the United States which has charge of the administration of the laws in respect of which the claim of the United States arises.

(j) Whenever any person has a lien upon any real or personal property, duly recorded in the jurisdiction in which the property is located, and a junior lien, other than a tax lien, in favor of the United States attaches to such property, such person may make a written request to the officer charged with the administration of the laws in respect of which the lien of the United States arises, to have the same extinguished. If after appropriate investigation, it appears to such officer that the proceeds from the sale of the property would be insufficient to wholly or partly satisfy the lien of the United States, or that the claim of the United States has been satisfied or by lapse of time or otherwise has become unenforceable, such officer shall certify to the Comptroller General who may issue a certificate releasing the property from such lien.

Appendix

New York Civil Practice Act:

Sec. 1082. Final Judgment; Surplus Moneys

1. In an action to foreclose a mortgage upon real property, if the plaintiff becomes entitled to final judgment, it must direct the sale of the property mortgaged or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale and the costs of the action except as provided in subdivision two of this section. All surplus moneys arising from the sale of mortgaged premises under any judgment shall be deposited by the officer appointed to conduct the sale of the premises within five days after the same shall be received and be ascertainable to the credit of the action in a bank or trust company named by the court in the final judgment unless otherwise specially directed, subject to the further order of the court; and every judgment in foreclosure shall contain such directions, except where other provisions are made specially by the court. Any person claiming the surplus moneys arising upon the sale of mortgaged premises, or any part thereof, either in his own name or by his attorney at any time before the confirmation of the report of sale, may file with the clerk in whose office the report of sale is filed a written notice of such claim, stating therein the nature and extent of his claim and the address of himself or his attorney. A motion to confirm such report of sale shall not be made within three months after the filing of the report and shall in any event be made not later than four months after the filing of such report, except that if

there be no surplus moneys arising from the sale of the mortgaged premises under such judgment, an application for confirmation of the report of sale may be made at any time after the report shall have been filed eight days. Where the report of sale shows surplus money the party moving for confirmation of the report of sale shall present with his motion papers a proper voucher for the surplus moneys showing that they have been paid over, deposited or disposed of in pursuance of the judgment, a certificate of the clerk specifying the notices of claim to the surplus moneys, if any, so filed with him, and an affidavit showing any other unsatisfied lien on the property. Where it appears to the court, on such motion for confirmation of the report of sale, that the owner of the equity of redemption in the action is entitled to all of the surplus moneys, and is the only person claiming the same, it may order that such surplus moneys shall be paid over to such owner or his assigns by the officer appointed to conduct the sale of the premises, without further proceedings. Where it appears on such motion that the owner is not the only person claiming such surplus, the court shall direct the sheriff or referee making the sale, within five days after such order is made, to pay such surplus moneys in the city of New York to the treasurer of the said city, and in other counties outside of the city of New York, to the treasurer thereof, unless otherwise specially directed, subject to the further order of the court. In case of the death, disability, or removal of the officer appointed to conduct the sale of the premises, the court may

grant an order authorizing the bank or trust company in which such surplus moneys are deposited to pay them over to the person or persons entitled thereto.

SEC. 1087. PAYMENT OF TAXES, ASSESSMENTS AND WATER RATES OUT OF PROCEEDS OF SALE.

Where a judgment rendered in an action to foreclose a mortgage upon real property directs a sale of the real property, the officer making the sale must pay out of the proceeds, unless the judgment otherwise directs, all taxes, assessments and water rates which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments or water rates which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale within the meaning of that expression as used in any provision of this article. The provisions of this section shall not apply to any judgment in an action wherein any municipal corporation of this state is the plaintiff and the purchaser at the foreclosure sale thereunder.

New York Real Property Law:

SEC. 240. DEFINITIONS AND USE OF TERMS.

2. The term "conveyance", as used in this article, includes every instrument, in writing, except a will, by which any estate or interest in real property is created, transferred, assigned or surrendered.

SEC. 290. DEFINITIONS; EFFECT OF ARTICLE.

3. The term "conveyance" includes every written instrument, by which any estate or interest in real

property is created, transferred, mortgaged or assigned, or by which the title to any real property may be affected, including an instrument in execution of a power, although the power be one of revocation only, and an instrument postponing or subordinating a mortgage lien; except a will, a lease for a term not exceeding three years, an executory contract for the sale or purchase of lands, and an instrument containing a power to convey real property as the agent or attorney for the owner of such property.

Section 1626 of the Code of Civil Procedure of the State of New York, predecessor to Section 1082 of the New York Civil Practice Act, as adopted by Chapter [illegible] of New York Laws of 1880:

In an action to foreclose a mortgage upon real property, if the plaintiff becomes entitled to final judgment, it must direct the sale of the property mortgaged, or of such part thereof as is sufficient to discharge the mortgage debt, the expenses of the sale, and the costs of the action.

Section 1676 of the Code of Civil Procedure of the State of New York, predecessor to Section 1087 of the New York Civil Practice Act, as adopted by Chapter 178 of New York Laws of 1880:

Where a judgment, rendered in an action for partition, for dower, or to foreclose a mortgage upon real property, directs a sale of the real property, the officer making the sale must, out of the proceeds, an

less the judgment otherwise directs, pay all taxes, assessments, and water rates, which are liens upon the property sold, and redeem the property sold from any sales for unpaid taxes, assessments, or water rates, which have not apparently become absolute. The sums necessary to make those payments and redemptions are deemed expenses of the sale, within the meaning of that expression, as used in any provision of article second, third or fourth of this title.

Revised General Statutes of Connecticut, 1949; Title 58:

Sec. 7208. Disposal of Proceeds of Sale.

The proceeds of each such sale shall be brought into court, there to be applied if the sale be ratified, in accordance with the provisions of a supplemental judgment then to be rendered in such cause, specifying the parties who are entitled to the same and the amount to which each is entitled; and, if any part of the debt or obligation secured by the mortgage or lien foreclosed or by any subsequent mortgage or lien was not payable at the date of the judgment of foreclosure, it shall nevertheless be paid as far as may be out of the proceeds aforesaid as if due and payable with rebate of interest where such debt was payable without interest, provided, if the plaintiff be the purchaser at any such sale, he shall be required to bring into court only so much of such proceeds as shall exceed the amount due upon his judgment debt, interest and costs.

Appendix

SEC. 7210. EXPENSES OF SALE AND COSTS

The court shall order the judgment and costs of the plaintiff to be first paid out of the proceeds of such sale and shall allow, to such of the parties as receive the balance of such proceeds, the costs usually allowed to successful parties, which costs shall be paid in addition to their respective claims and in the same order.

House of Representatives Report 1018, 62nd Congress, 2d Session:

LIEN FOR TAXES.

July 17, 1912. Referred to the House Calendar and ordered to be printed.

Mr. Sterling, from the Committee on the Judiciary, submitted the following

REPORT

(To accompany H. R. 25780.)

The Committee on the Judiciary, to whom was referred the bill (H. R. 25780) to amend section 3186 of the Revised Statutes of the United States, report the same to the House with a recommendation that it do pass.

Section 3186 of the Revised Statutes is as follows:

"SEC. 3186. If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United

States from the time it was due until paid, with the interest, penalties, and costs that may accrue in addition thereto upon all property and rights to property, belonging to such person.

This section makes any delinquent tax due the United States a lien on all the property of the person delinquent in the payment of the tax, wherever it may be situated within the United States. A person proposing to buy the property of another could protect himself against such a lien only by ascertaining from all the collectors in the United States whether or not the vendor was delinquent in the payment of taxes. This would be a great hardship and would make it practically impossible for any person proposing to buy property to secure himself against such liens. The same hardship would devolve upon mortgagees and judgment creditors. It is proposed to amend the section by adding the following:

Provided, however, That such lien shall not be valid as against any mortgagee, purchaser, or judgment creditors until notice of such lien shall be filed by the collector in the office of the registrar or recorder of deeds of the county or counties, or parish or parishes in the State of Louisiana, within which the property subject to such lien is situated: Provided further, That the provision herein relating to the filing of notice shall be applicable whenever, and only whenever, the laws of the State wherein the property is situated shall authorize the filing of such notice in the office of the registrar or recorder of deeds as provided herein.

The amendment becomes effective in any State only when the legislature of that State authorizes the filing of notice of such lien by the collector in the office of the registrar or recorder of deeds of the county or parish where the property is situated.

It provides a very simple means of giving this notice that would not at all be burdensome upon the Government.

In the case of the United States v. Snyder (149 U. S. 210) the Supreme Court held that the lien created by section 3186 is a valid and binding lien even against a bona fide purchaser or encumbrancer in good faith for value, without knowledge or notice of the existence of such a lien. The Federal statute makes no provision for giving notice, constructive or otherwise, of the lien created by said section, and in the case above cited it was held that the recording acts of the several States have no force or effect as against the lien of the Government; and the lien is so comprehensive that it covers all the property and rights to property of the delinquent situated anywhere in the United States, and any person taking title to real estate is subjected to the impossible task of ascertaining whether any person who has at any time owned the real estate in question has been delinquent in the payment of the taxes referred to while the owner of the real estate in question. The business carried on under the internal-revenue law may be at a great distance from the property affected by this secret lien, but this will not relieve the property from the lien.

The recent act relating to excise tax by corporations makes it imperative that some legislation of this kind be enacted in order to protect the transfer of property and to facilitate business transactions. *There is no reason why the Government should not occupy the same position with reference to liens as property as does the individual.* (Emphasis Supplied).

It is believed that the States will very readily pass legislation authorizing the filing of notice in the office of the registrar or recorder of deeds, in order to protect its citizens in business transactions against liens which the citizens can not know of except at great cost of money and time. This law simply gives the States the opportunity to do so if it wishes to save its citizens from this unnecessary burden.

House of Representatives Report 95, 71-t Congress, 2nd Session:

TO PERMIT THE UNITED STATES TO BE MADE A PARTY DEFENDANT IN CERTAIN CASES.

December 21, 1929.—Referred to the House Calendar and ordered to be printed

Mr. Graham, from the Committee on the Judiciary, submitted the following

REPORT

(To accompany H. R. 980)

The Committee on the Judiciary, to whom was referred the bill H. R. 980, after consideration reports the same favorably and recommends that the bill do pass

This bill is identical with the bill H. R. 13981, which was favorably reported by this committee in the Seventieth Congress and passed the House by unanimous consent.

This legislation has been recommended for a number of years by the American Bar Association through its committee on removal of Government liens on real estate, the United States League of Local Building and Loan Associations, and by numerous land title companies, in order to relieve against the injustice with which mortgagees are confronted under the present state of the law who find, when it is necessary to foreclose their mortgages, that there has been filed against the property a junior lien by the Federal Government for some debt due the United States by the owner of the equity in the property, and for which the mortgagee owes no obligation either legal or moral. In such circumstances the mortgagee finds himself at an *impasse*. It is impossible for him to bring about a judicial sale of the property owing to the cloud upon the title created by the Government's lien. He cannot remove the lien as there is no method by which he may bring the United States in as one of the parties to the foreclosure proceeding. *He is, therefore, in effect defeated of his own right to foreclose unless he is willing to pay off the Government lien, a debt for which he is in no way responsible and he being a person to whom the Government would in no event look for its payment.* (Emphasis Supplied). Insertion of parentheses is a printers error

Appendix.

The purpose of this bill is to provide a simple and just method of proceeding in such cases; one which is fair to the holder of the prior lien on the real estate and which amply and fully protects the rights of the Federal Government.

LIBRARY

INDEX

	Page
I. The *New Britain* case cannot be distinguished and is controlling here	2
II. The *New Britain* case was correctly decided and should be reaffirmed	8

CITATIONS

Cases:

Aquilino v. *United States*, 363 U.S. 509	2, 12
Bacon v. *Van Schoonhoven*, 19 Hun 158, affirmed, 87 N.Y. 446	11
Crest Finance Co. v. *United States*, 368 U.S. 347	6, 7
Illinois v. *Campbell*, 329 U.S. 362	9
Michigan v. *United States*, 317 U.S. 338	9
New York v. *Maclay*, 288 U.S. 290	9
Spokane County v. *United States*, 279 U.S. 80	9
United States v. *Ball Construction Co.*, 355 U.S. 587	7
United States v. *Bond*, 279 F. 2d 837, certiorari denied, 364 U.S. 895	7, 8
United States v. *Brosnan*, 363 U.S. 237	2, 5
United States v. *New Britain*, 347 U.S. 81	1, 3, 7, 8, 9
United States v. *Durham Lumber Co.*, 363 U.S. 522	2, 9
United States v. *Texas*, 314 U.S. 480	9
United States v. *Union Central Life Ins. Co.*, 368 U.S. 291	8

665995—62

Statutes:

	Page
Internal Revenue Code of 1939, Sec. 3672(a) (26 U.S.C. 1952 ed., Sec. 3672(a))	3, 7, 8, 10
Internal Revenue Code of 1954, Sec. 6323(a) (26 U.S.C. 1958 ed., Sec. 6323(a))	3
28 U.S.C. 2410	5, 6, 7

Miscellaneous:

IV *American Law of Property*, Sec. 17.33, pp. 627–629	11
Campbell, *Protection Against Indirect Attack*, *Harvard Legal Essays*, pp. 3, 16–20	11
Circuity of Liens a Proposed Solution, 38 Col. L. Rev. 1267 (1938)	11
Osborne on *Mortgages* (1951), Sec. 209, pp. 532–539	11
Plumb and Wright, *Federal Tax Liens* (July, 1961), p. 78	11

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 96

UNITED STATES, PETITIONER

v.

BUFFALO SAVINGS BANK

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

REPLY BRIEF FOR THE UNITED STATES

The government's position in this case rests upon three basic propositions of federal law underlying the decision of *United States* v. *New Britain*, 347 U.S. 81: (1) that perfected federal and State tax liens are of equal dignity; (2) that their priority is determined by application of the rule of first in time, first in right; and (3) that State law cannot impair the priority of the federal tax lien. The application of these propositions to the facts of this case, requiring reversal of the decision below, is not dislodged by any of the arguments advanced either by the Buffalo Savings Bank or by the *amicus curiae*, the American Bar Association. The Bank argues that the *New Britain* decision can be distinguished; the *amicus*

urges that *New Britain* be reconsidered and overruled, but, taken together, their arguments serve only to emphasize that *New Britain* was rightly decided on the basis of fundamental principles of law, and is controlling here.

I

THE *NEW BRITAIN* CASE CANNOT BE DISTINGUISHED AND IS CONTROLLING HERE

The brief of Buffalo Savings Bank, like the opinion below, rests primarily upon the contention that *New Britain* is distinguishable.[1] Most of the arguments advanced by the Bank were anticipated and answered in the government's main brief. Here, we briefly summarize the Bank's arguments and our answers.

1. The Bank first asserts (Br. 6–8) that under New York law the taxpayer-mortgagor's property interest in the mortgaged property—to which the federal lien attached—is diminished by the mortgagee's right to have local real estate taxes and assessments be first paid as "expenses" of any foreclosure sale. As the government pointed out in its main brief (pp. 15–17), this is not so. Under New York law, the mortgagor is the owner of the fee, subject only to the mortgage; and, as this Court said in *United States* v. *Brosnan*, 363 U.S. 237, 241, the property interest of the mortgagor to which the federal lien can attach is not di-

[1] The Bank recognizes (Br. 25, fn. 2) that an argument that the Court in *Aquilino* v. *United States*, 363 U.S. 509, and *United States* v. *Durham Lumber Co.*, 363 U.S. 522, recognized the right of a State by statute to make the ownership rights of a taxpayer in real property subject to diminution by annual real estate taxes so that the federal lien attaches only to the diminished ownership "would, of course, amount to a refutation of the New Britain doctrine."

minished by the particular means of enforcement possessed by a prior mortgagee.

2. The Bank attempts (Br. 8–12) to distinguish *New Britain* on two grounds. First, it argues that the mortgagee was not a party to the *New Britain* case, so that the problem of circuity of liens and the mortgagee's rights under the recordation statute (Section 3672 of the 1939 Code; now Section 6323 of the 1954 Code) was not presented. A review of the briefs in that case is sufficient to refute the Bank's argument. They show that the parties presented extensive arguments addressed to the point that under the rule of "first in time, first in right" local taxes would be paid from the share of the mortgagee to whom Congress had granted priority in Section 3672. Thus, the government stated in its opening brief in *New Britain* (Br. 17):

> Full effect would be given to the federal statute by setting aside funds sufficient to pay the mortgages and judgment (covered by Section 3672) before satisfying the federal liens. Connecticut could then satisfy the municipal liens (excluded from Section 3672) from the sum so set apart. This procedure, suggested by the Government and referred to by this Court in *Spokane County* v. *United States*, 279 U.S. 80, 91—and adopted in *Samms* v. *Chicago Title & Trust Co.*, 111 N.E. 2d 172 (Ill. App.)—is the only one by which both the federal and the state law are given effect to the fullest permissible extent. If the end result be deemed incongruous in that the State takes from mortgagee and judgment creditor part or all of what the Federal Government leaves with them, the

> "incongruity arises by virtue of [the] state law and not by virtue of the federal enactment." *Samms* v. *Chicago Title & Trust Co.*, *supra*, at 176. The State is free, of course, to subordinate the liens of its municipality in situations of this kind and rank them last on the ground that they fall behind the federal liens which yield in turn to the mortgages and judgment. The State is not free, however, unless Congress grants a further exception thus far withheld, to protect its City's liens at the expense of the paramount federal liens.

Thereafter, the City of New Britain filed a supplemental brief and the United States, a reply brief, which were devoted primarily to a consideration of this very issue (see Supplemental Brief for Respondent, City of New Britain, pp. T2–T3, T4, N1; Reply Brief for the United States, pp. 1–10).[2] As stated in our main brief (pp. 26–27), this Court was thus fully informed in *New Britain* that its decision required the mortgagee, who was accorded priority by the federal law, to bear the burden of the later arising local taxes when it held that the mortgagee would only be entitled to recover as against the federal tax lien "the amount necessary to pay the mortgage."

The Bank also argues (Br. 11): "In Connecticut the real estate taxes and assessments are paid because

[2] Under the circumstances, there is no basis for the bank's contention (Br. 9–10) that "[i]t was not until the case went back to the Superior Court of Hartford County, on remand from this Court, as Brown vs. General Laundry Service, Inc., 19 Conn. Sup. 335, 113 A. 2d 601, that the question of 'circular priority' entered the case to reduce the amount previously set aside for the judgment creditor, William G. Dunn, in order to pay in full the federal tax lien."

they are liens on the mortgaged property, while in New York they are paid as expenses of the foreclosure sale." As the government pointed out in Point B-2 of its main brief (pp. 18–22), a State cannot by the choice of a label subordinate a federal tax lien to any later arising state-created lien.

3. The Bank errs in contending (Br. 13–15) that the *Brosnan* case supports the decision below on the theory that the Pennsylvania foreclosure proceedings there involved resulted not only in divesting the property of the junior federal lien, but also in paying fully the later-arising local tax liens. The *Brosnan* decision does not deal with or decide the latter issue. As we stated in our main brief (pp. 22–25), the only question presented in *Brosnan* was whether a mortgagee could divest the property of junior federal tax liens by procedures other than those outlined in the federal statute (28 U.S.C. 2410). The United States contended that it could not and asserted that despite the State-authorized foreclosure it still retained a lien on the real property or at least a right of redemption. The decision rejected the government's contentions and held that procedures authorized by State law for the foreclosure of senior liens and the divestiture of all junior liens could be recognized without impairing the priority of the federal tax lien (363 U.S. at 250–252). The *Brosnan* decision thus relates solely to the procedures whereby a senior lienor may divest the real property of a junior federal lien. The federal government never presented and the decision in no way determined the issue for which it is cited by petitioner—whether proceeds of the foreclosure sale

over and above those necessary to satisfy the senior lien could lawfully be used to satisfy later-arising tax claims of the State prior to those of the federal government which had priority under federal law.[5]

4. The Bank's fourth contention (Br. 15–17) is that under the government's concession in *Crest Finance Co. v. United States*, 368 U.S. 347, that a mortgage lien on property is not rendered inchoate because the value of the security is uncertain, "it follows that there can be no objection in this case to the fact that the mortgagor's equity in the mortgaged premises varies in value, by decreasing as real estate taxes and assessments are levied against the mortgaged property, pursuant to an established tax rate, after the filing of the federal lien." This conclusion of the Bank is a *non sequitur* and rests upon a misinterpretation of the government's position in *Crest Finance*. In *Crest*, the prior lien was in a definite amount, fixed before the federal tax lien arose, and the property to which the lien attached was fixed and certain; the government conceded only that the necessity for final ascertainment of the value of this property subject to the lien[6] did not affect its choateness.

[5] The Bank overemphasizes (Br. 14) the quoted excerpt from the government's brief in *Brosnan*. The government was there simply explaining one of the consequences that might result if Section 2410 procedures were not held to be exclusive. Whether the consequence would have been upheld as consistent with federal tax lien priorities was an issue left by the government for litigation in another case.

[6] The lien attached to moneys due under the terms of a specific contract for work already performed in delivering truckloads of fill. By the time the tax assessments were made, the taxpayer had completed performance of the contract and all

The government expressly distinguished the case of *United States* v. *Ball Construction Co.*, 335 U.S. 587, where this Court held that a prior lien could not be extended to include future, contingent claims, which is exactly the character of the later arising local real estate tax liens here involved. (Cf. government's main brief, p. 21.)

5. The Bank also urges (Br. 17–27) that it was the intention of Congress, as evidenced by its enactment of Section 3672(a) of the Internal Revenue Code of 1939 (now Section 6323(a) of the 1954 Code) and 28 U.S.C. 2410, to protect the "mortgagee," not only as to the principal indebtedness, but also as to any disbursements necessary for the protection or preservation of the mortgage lien. This contention, as already noted (*supra*, pp. 3–4), was rejected by *New Britain*. See 347 U.S. 81, 88. The Bank adds nothing to the arguments advanced on this issue in *New Britain* other than the dissenting opinion of Judge Haynsworth in *United States* v. *Bond*, 279 F. 2d 837 (C.A. 4), cer-

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that remained to be done was the final computation of the precise amount due. This was to be based upon an engineering measurement of the compacted fill instead of a measurement based on the number of truckloads delivered, on which weekly estimates had been based. The United States conceded that this final computation of the value of the security (from an estimated figure based on truckloads to a precise figure based on the engineering measurement of the compacted fill) did not render the lien of Crest inchoate when it was specific and definite in three essential respects: (1) the identity of the lienholder (Crest Finance); (2) the amount of the lien; and (3) the property to which it attached (the accounts receivable for the work already performed under the specific contract). See Memorandum for the United States in *Crest Finance Co., Inc.* v. *United States*, *supra*, at 5.

tiorari denied, 364 U.S. 895. The decision of this Court in *United States* v. *Union Central Life Ins. Co.*, 368 U.S. 291, decided subsequent to *Bond*, fully discusses the legislative history of the recordation provision, and holds that the sole purpose of that provision was to protect mortgagees (as well as pledgees, purchasers and judgment creditors) from secret government liens. To accomplish this, it provided that in order to be "valid" against such claimants, the federal tax lien had to be recorded. Nothing in the statute or its legislative history suggests that Congress undertook to define the nature and extent of a mortgagee's interest in property, or to alter the fundamental rules of priority of federal and competing liens in any other respect. In short, Section 3672 merely added the requirement of recordation to the federal tax lien. It added nothing to the mortgage lien.

II

THE *NEW BRITAIN* CASE WAS CORRECTLY DECIDED AND SHOULD BE REAFFIRMED

The American Bar Association, in its *amicus curiae* brief, urges this Court to reconsider and overrule the *New Britain* decision. It concedes that affirmance of the decision below would require overruling *New Britain*.

1. The first ground upon which re-examination is urged is the claim that a State tax lien is inherently superior to a federal tax lien, and that the *New Britain* decision "fails to recognize the essential difference between real property taxes and federal taxes generally" (Amicus Brief, p. 9). While the govern-

ment has answered this argument in its main brief (pp. 13–15), we point out additionally that acceptance of this argument would necessitate overruling not merely *New Britain*, but also *Michigan* v. *United States*, 317 U.S. 338; *Spokane County* v. *United States*, 279 U.S. 80; *New York* v. *Maclay*, 288 U.S. 290; *United States* v. *Texas*, 314 U.S. 480; and *Illinois* v. *Campbell*, 329 U.S. 362, which directly uphold the supremacy of the federal tax lien against the priority accorded by a State law to its tax liens. It is, in short, a contention that federal law must yield to State law in the field of lien priorities. The long-settled answer of this Court is well stated in *Michigan* v. *United States*, *supra*, where the State of Michigan claimed priority for its real estate tax liens over the unrecorded lien of the United States for estate taxes which arose at the date of death (317 U.S. at 340–341):

> We do not stop to inquire whether this construction of the state statutes is the correct one, for we think the argument ignores the effect of a lien for federal taxes under the supremacy clause of the Constitution. The establishment of a tax lien by Congress is an exercise of its constitutional power "to lay and collect taxes." Article I, § 8 of the Constitution. *United States* v. *Snyder*, 149 U.S. 210. And laws of Congress enacted pursuant to the Constitution are by Article VI of the Constitution declared to be "the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

"It is of the very nature and essence of a lien, that no matter into whose hands the property goes, it passes *cum onere*." *Burton* v. *Smith*, 13 Pet. 464, 483; *Rankin* v. *Scott*, 12 Wheat. 177, 179; *Howard* v. *Railway Co.*, 101 U.S. 837, 845. Hence it is not debatable that a tax lien imposed by a law of Congress, as we have held the present lien is imposed, cannot, without the consent of Congress, be displaced by later liens imposed by authority of any state law or judicial decision. *United States* v. *Snyder*, *supra*; *United States* v. *Greenville*, 118 F. 2d 963. Similarly we held that the priority of payment commanded by R. S. § 3466 could not be set aside by state legislation. *United States* v. *Texas*, 314 U.S. 480, 486; *Spokane County* v. *United States*, 279 U.S. 80; *New York* v. *Maclay*, 288 U.S. 290; cf. *Missouri* v. *Ross*, 299 U.S. 72.

As the federal lien with which we are here concerned attached to private property prior to the acquisition of any interest in that property by the state, we need not consider the extent to which Congress may give, or intended by § 315(a) to give, priority to a federal lien over a previously perfected state lien. Compare *New York* v. *Maclay*, *supra*, 292; *Spokane County* v. *United States*, *supra*, 95; *United States* v. *Texas*, *supra*, 484–486.

2. We have already answered (*supra*, pp. 3–4, 7–8) the Bar Association's contention (pp. 11–19) that the interests of the mortgagee were not considered in *New Britain* and that the prior mortgagee is deprived of the protection intended by Congress by virtue of the provisions of Section 3672(a) of the 1939 Code if

the subsequent property taxes must be paid from its share of the proceeds of sale of the mortgaged property. The "bizarre" results described by the *amicus* brief (pp. 12–13) are in substance no more than the inevitable consequences of the different rules of priority established by federal and State law. The federal rule with respect to its tax liens is a strict rule of first in time, first in right; the State rule accords tax liens, and other State-created liens, exceptional priority.[8] The *amicus* brief would resolve the problem by denying the supremacy which federal law gives to federal liens.[9]

3. Finally, the *amicus* presents the view (Br. 19–21) of "[s]ome lawyers" of the American Bar Association that the entire issue of priorities is a matter of state property law. This Court, however, has re-

[8] The argument that the federal tax lien should be subordinated to everything which is ahead of the mortgage would not only subject the federal tax lien to other State preferred liens, such as landlord's and mechanic's liens, but is logically fallacious. One might "just as well start at any point on the circle—*e.g.*, by contending that the United States, being ahead of the property tax, is ahead of everything that is inferior to the property tax, including the pre-existing mortgage." Plumb and Wright, *Federal Tax Liens* (July 1961), p. 78.

[9] The problem of so-called circuity of liens, arising in non-federal contexts, is an old one, for which there is no perfect solution. Osborne on *Mortgages* (1951), Sec. 209, pp. 532–539; IV *American Law of Property*, Sec. 17.33, pp. 627–629; *Circuity of Liens—A Proposed Solution*, 38 Col. L. Rev. 1267 (1938); Campbell, *Protection Against Indirect Attack*, *Harvard Legal Essays*, pp. 3, 16–20. The solutions depend upon the legal relationships of the parties in each particular case. In meeting this problem, the Court of Appeals of the State of New York has adopted a rule similar to the *New Britain* rule. *Bacon* v. *Van Schoonhoven*, 89 Hun 158, affirmed, 87 N.Y. 446.

peatedly rejected this view and held that the relative priority of a federal tax lien is a question of federal, not State, law—a view which the Court recently reiterated in *Aquilino* v. *United States*, 363 U.S. 509, 512–514.

Respectfully submitted.

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Both *Aquilino* and *United States* v. *Bonham Lumber Co.*, 363 U.S. 522, turned on the question whether, as a matter of State law, the respective taxpayers had property interests in the funds to which the federal government had laid claim. Contrary to the suggestion of the *amicus* (Br. 21), State law was not applied to determine priorities.

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No. 96

IN THE

Supreme Court of the United States

October Term, 1962

UNITED STATES,

Petitioner,

v.

BUFFALO SAVINGS BANK.

ON WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

ANSWERING BRIEF OF RESPONDENT TO REPLY BRIEF FOR THE UNITED STATES

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INDEX.

	PAGE
I. The Reply Brief of the United States Contains Erroneous and Misleading Statements Which Must Be Corrected	1

CITATIONS.

CASES:

Bank of America National Trust and Savings Assoc. vs. United States, 363 U. S. 237 (1960)	3
City of New York vs. United States, 283 F. 2d 829 (1960)	2
Metropolitan Life Insurance Co. vs. United States, Sixth Circuit 107 F. 2d 311 (1939) Cert. denied 310 U. S. 630	3
Paddell vs. City of New York, 211 U. S. 446, 450	2
United States vs. Ball Construction Company, Inc., 355 U. S. 587 (1958)	6
United States vs. Brosnan, 363 U. S. 237	7
United States vs. City of New Britain, 347 U. S. 81	6
United States vs. Cox, 119 Fed. Supp. 147 District Court, Northern District of Georgia (1953)	3
Wesselman vs. Engel Company, 309 N. Y. 27 (1955)	5

STATUTES:

Section 1082 New York Civil Practice Act	5, 6
Section 1087 New York Civil Practice Act	5, 6
Title 28 U. S. C. 2410	6

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I.

The Reply Brief of the United States contains erroneous and misleading statements which must be corrected.

Respondent wishes to answer the Government's Reply Brief because of some erroneous and misleading statements therein.

The first of these appears on page 1 of the Reply Brief and is as follows:

"perfected federal and state tax liens are of equal dignity".

Federal tax liens and local real estate tax liens are so different that to say they are of equal dignity is meaningless. The New York Court of Appeals in its opinion herein stated: "The local Government lien is not a levy against the mortagor, but against the land * * *" (R. 76). *Amicus Curiae* in its Brief at page 6 puts it this way: "(state) taxes are levied upon the land itself, without regard to the separate interests therein." The point of this is not that state taxes are liens on specific properties, while federal tax liens are general liens on all the property of the debtor, but that as to any given property of the tax debtor the state tax is a lien on all the interests in that property including that of the owner, any mortgagee, and any judgment creditor (Paddell vs. City of New York, 211 U. S. 446, 450); while the federal tax lien attaches only to the interest of the taxpayer owner in that property at the time the federal tax lien is filed. This interest of the taxpayer owner can and does vary according to his previous contractual dealings with that property.

Chief Judge Lufbard of the Second Circuit recognized this in City of New York vs. United States, 283 F. 2d 829 (1960), when, in discussing what property rights to which a federal tax lien might attach after the taxpayer debtor had made a general assignment for the benefit of creditors under the New York Debtor and Creditor Law, he said at page 832:

> "The Section 6321 lien attaches only to the extent of the taxpayer's property interest, United States v. Burgo, 3 Cir., 1949, 175 F. 2d 196, and is not a proper basis for a levy on contingent rights before they come into being. United States v. Long Island Drug Co., 2 Cir., 1940, 115 F. 2d 983. Thus, the property, after

it had been assigned by the taxpayer, could not be subjected to the government's lien."

In United States v. Cox, 119 Fed. Supp. 147, District Court, Northern District of Georgia (1953), a federal tax lien was filed after the execution of a mortgage in the Georgia form of a deed of trust. The Court at page 150 said:

> "The taxpayer having executed the deed to secure a debt, which deed was entered of record before the recording of the notice of lien of the United States, this Court must determine what, if any, interest the taxpayer retained in the property after making the deed, and consequently what interest, if any, the taxpayer had at the time of the record of the government's claim of lien."

Circuit Judge Hamilton in Metropolitan Life Ins. Co. v. United States, Sixth Circuit, 107 F. 2d 311 (1939), Cert. denied 310 U. S. 630, at page 313 defines the property interest of the taxpayer to which the Federal lien attaches as follows:

> "The lien of the government attaches to all of the property in possession of the taxpayer to the extent of his interest in and rights thereto, depending upon contracts and unexecuted instruments . . ."

The holding in this 1939 case, that a federal tax lien cannot be wiped out by a non-judicial sale pursuant to a power of sale contained in the mortgage, was specifically reversed by this Court in Bank of America National Trust and Savings Association vs. United States, 363 U. S. 237 (1960). Therefore, the dissenting opinion of Circuit Judge Arant in Metropolitan Life Ins. Co. vs. United States (*supra*) is of particular interest. At page 314, he says:

> "The lien of the United States involved herein was based upon an income tax, not a property tax; and attached only to 'property and rights to property, whether real or personal, belonging to' the tax debtor.

R. S. Sec. 3186, U. S. C., title 26, Sec. 1560, 26 U. S. C. A. Section 1560."

* * *

"The conclusion is inescapable, therefore, that the tax lien attaches only to the destructible interest that remains in a mortgagor after execution of a mortgage with a power of sale."

and at page 315:

"No attribute of sovereignty of the United States can increase the interest of a property owner. See Trust Co. of Texas v. United States, D. C., 3 F. Supp. 683."

2. In the light of all the foregoing, the Government's statement at page 2 of its Reply Brief, as follows:

"Under New York law, the mortgagor is the owner of the fee, subject only to the mortgage; and, as this Court said in United States vs. Brosnan, 363 U. S. 237, 241, the property interest of the mortgagor to which the federal lien can attach is not diminished by the particular means of enforcement possessed by a prior mortgagee."

must be examined. Without question, regarding the legal status of mortgages, New York is a so called lien state. In New York a mortgagor does not convey his fee interest to the mortgagee subject to defeasance upon payment of the debt secured. All he does is give the mortgagee a lien on the mortgaged property. But by the creation of this lien on his property he has reduced his ownership rights in the property. Before his title was unencumbered. Now it is encumbered. Furthermore, it is encumbered exactly to the extent provided by the terms of that mortgage. He has assigned conveyed mortgaged certain ownership rights in his property beyond the reach of the federal lien. In the case at bar the mortgage (as do all New York mortgages) provided that on a default, the mortgagee "was thereby empowered to sell the mortgaged premises according to law". (Original 60, point 32). The

law referred to (Secs. 1082 and 1087 of the New York Civil Practice Act) was thereby made a part of the mortgage terms, and the mortgagor thereby and at that time reduced his ownership rights in the mortgaged premises by giving to the mortgagee the right, conferred by these Civil Practice Act provisions, to require the payment of real estate taxes as an expense of sale, before any surplus moneys (as defined by Section 1082 of the New York Civil Practice Act) are created, to which junior encumbrancers (including the United States under its tax lien), and in the absence of any junior encumbrancers, the owner, is entitled. This right is a property right, and not a mere "particular means of enforcement possessed by a prior mortgagee." It enables the mortgagee to give good title to the purchaser on the sale.

This has been the law in New York since 1880 (See Main Brief). It can hardly be called an attempt by a state legislature through the characterization of a claim to control the priority of federal liens. The New York Court of Appeals in Wesselman v. Engel Company, 309 N. Y. 27 (1955) in discussing the applicability of this Section 1087 to an independent private guarantee of "expenses of foreclosure" said at page 30:

> "It is said that the aforementioned taxes and assessments are 'expenses of foreclosure of said mortgage' within the terms of said guarantee, and reliance for this holding is placed on section 1087 of the Civil Practice Act. But that statute says nothing about '*expenses of foreclosure*'. It merely provides that taxes and assessments '*which are liens upon the property sold* • • •' are deemed expenses of the *sale* within the meaning of that expression as used in any provision of *this article*.' (Emphasis supplied.) The purpose of this section is to protect, not the mortgagee, but the purchaser on a foreclosure sale, who is entitled to a clear title (Moyer v. Wilson, 248 App. Div. 5, Mod. 276 N. Y. 161; Equitable Life Assur. Soc. v. Toplitz,

> 69 Misc. 457, Affd. 143 App. Div. 929; Coudert v. Huerstel, 60 App. Div. 83). In short, it directs the referee to pay out of the proceeds of the sale *unpaid* taxes and assessments so that he can give title free of such then existing liens."

This established New York law has created property rights long relied on by New York mortgagees. The question before this Court now is, must it (the law set forth in the statutes—Sections 1082 and 1087 New York Civil Practice Act) be stricken down because the federal tax collector finds it incidentally impedes him in collecting his taxes, not from the taxpayer, but from the mortgagee of the taxpayer's property, the latter having been referred to by Congress when adopting the predecessor to Section 2410 U. S. C. 28, as "being a person to whom the Government would in no event look for its (the federal tax) payment" (Main Brief Page 18).

3. Respondent respectfully contends that the fact the Government and the City of New Britain may have discussed in their briefs in U. S. vs. City of New Britain, 347 U. S. 81, the effect on mortgagees and judgment creditors of this Court's decision in that case, does not alter the fact that the mortgagee and judgment creditor were not in Court when the argument was made. It is still a correct statement to say that they, the persons most directly involved, did not have an opportunity to state their case. And it is equally true that this Court in that case was concerned only with the relative priority of federal and state taxes in regard to the surplus and not with the rights of mortgagees and judgment creditors.

The dissenting opinion of Mr. Justice Whittaker in United States vs. Rail Construction Company Inc., 355 U. S. 587 (1958), in which he was joined by Mr. Justice Douglas, Mr. Justice Burton and Mr. Justice Harlan, expressly says

that they (the four dissenting justices) did not think the rights of mortgagees and judgment creditors were considered by the Court in New Britain. At page 590 of this dissent, it is said:

> "The controversy in New Britain was over that portion of the proceeds of a real estate mortgage foreclosure sale which exceeded the amount of the mortgage."

and at page 591, it is said:

> "We think it is not only apparent that Section 3672(a) had no application to that case but also that the Court expressly so declared."

and at page 592, it is said:

> "* * * in New Britain, this Court was not dealing with any mortgage, pledge or other contractual lien, or with any question of priority of an antecedent mortgage over subsequently filed tax liens."

4. On the other hand in the Brosnan case (U. S. v. Brosnan, 363 U. S. 237), the mortgagee was present with the Government. The fact that Pennsylvania foreclosure procedure required the payment of real estate taxes as an expense of sale was brought to this Court's attention (Main Brief Page 14). Furthermore, Pennsylvania mortgagees have, since that decision continued to pay local taxes from foreclosure sale proceeds without contributing toward the payment of federal tax liens, and the Government has not, since that decision, questioned this Pennsylvania practice.

As to the other matters discussed in the Government's Reply Brief, Respondent rests on its Main Brief.

November, 1962

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